Stock Data

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| Share Price: | 26.30p |
| Market Cap: | £83.84m |
| Shares in issue: | 322.45m |
| 52-week high/low: | 72.60p/16.05p |

Company Profile

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| Sector: | Technology |
| Ticker: | NANO |
| Exchange: | LSE |

Activities

Nanoco Group plc ('Nanoco', 'NANO', 'the Group') harnesses the power of nano-materials. These are materials with dimensions typically in the range 1 - 100 nm. Nano-materials have a range of useful properties, including optical and electronic. Nanoco is listed on the Main Market of the London Stock Exchange.

www.nanocotechnologies.com/

5-year share price performance

*Source: LSE*

Past performance is not an indication of future performance.

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TPI acts as joint broker to Nanoco Group plc.

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# Nanoco Group plc

**Nanoco has confirmed a transformative outcome for the Group in terms of its signing of final definitive agreements (collectively the 'Settlement') with Samsung for US$150m (c.£125m) to settle ongoing litigation with Samsung on a no-fault basis for the alleged infringement of its IP. Separately it has published a trading update for its half year ended 31 January 2023 in relation to the organic business, which has continued to make progress ahead of expectations in customer delivery and scaling for potential production orders this year. Although the cash settlement (which is to be paid in two equal tranches: by 5 March 2023 and by 3 February 2024) is below TPI's estimate of lost revenue in the range of USS$200m to US$300m for the US alone, Friday's outcome nevertheless draws proceedings, that otherwise appeared set for a further, possibly extended, period of appeal, legal work and negotiation, to a close. It leaves Nanoco more than adequately financed to build on the significant positive operating momentum achieved over the past few years, with an outlook for strong, near-term organic growth while remaining strongly positioned to continue protection of its now highly validated IP. Shareholders meanwhile have also been reassured of the Board's firm intention to distribute a "material return" of surplus capital. Taking on board the expected accounting impact of the Settlement (which is protected by existing carried forward tax losses in excess of £40m), balancing expected net cash against the Group's likely wish to invest substantially in its technologies for creation of a self-sustaining organic business, TPI considers it may be realistic for the Board to recommend distribution of up to £45m (potentially in the form of special dividends this year and next and/or a share buy-back).**

## Litigation settlement overview highlights

- Litigation concluded with US$150m cash settlement to be paid in two equal tranches (by 5 March 2023 and by 3 February 2024).
- Nanoco expected to retain over US$90m net proceeds after litigation costs.
- Settlement structured as a sale of non-core patents and a global, perpetual, fully paid-up licence agreement.
- Settlement ends all global litigation with Samsung; Nanoco's IP fully validated by the legal process.
- Nanoco retains full freedom to operate in all markets, territories, products and material types.

## Half-year trading update highlights

- Continued successful delivery of technical milestones throughout the period for the European Electronics and Asian Chemical customers.
- Revenue remains comfortably in line with the Board's expectations.
- Active cost management is delivering costs also comfortably in line with the Board's expectations.
- As a result of the factors above, combined with FX tailwinds, the Adjusted EBITDA loss for the year is now expected to be narrower than (and therefore ahead of) the Board's expectations.
- Net cash consumption in the Period was £0.8m, leaving a cash balance of £6.0m, also comfortably in line with the Board's expectations.

## Settlement ends all global litigation between Nanoco and Samsung

Considering Nanoco's own low case damages model (which was detailed and explored in numerous court papers some months back) of US$48.0m, TPI considers last Friday's negotiated outcome to be very positive for shareholders. This takes on board all risks associated with continuing to pursue the case in hope of an improved final result (which would potentially have exposed them to an extended appeals process along with, ultimately, the possibility of losing at trial etc., as well as the time value of money (bearing in mind that based on the Group's WACC an award of, say, US$500m in six years' time would only be worth c.US$200m in today's money). The Settlement instead ends all global litigation between the two parties (including the territories of Germany and China), in exchange for which Samsung will receive a fully paid up, perpetual, global licence that runs until the expiration of Nanoco's current individual patents.

Possibly setting a standard model for any similar, future patent infringement negotiations, the Settlement was structured in the form of two separate agreements:

- IP Licence agreement: This global, perpetual, fully paid-up licence agreement encapsulates any past or future royalties that would have been paid/become due to be paid.
- IP Sale agreement: This encapsulates the divestment of a number of non-core patents from Nanoco to Samsung, with Nanoco receiving a fully paid up, perpetual and global licence on the divested patents. Neither of the two patents due to be presented at trial were included in this sale.

## Expected accounting impact of the settlement

The sale of IP is expected to be accounted for as a profit on disposal of intangible assets in accordance with the requirements of IAS 38 Intangible Assets. This is expected to generate a net profit on disposal of approximately £70.0m based on the proceeds noted above less the current net book value of the patents at the point of sale. This profit on disposal will be recognised in the Group's FY2022/23 financial statements.

Income from the IP Licence agreement will instead be accounted for in accordance with the requirements of IFRS 15 Revenue from Contracts with Customers. It is expected that the revenue from the IP contract will be recognised over the average estimated remaining life of the existing entire IP portfolio after the sale of IP noted above, even though the cash will be received in the two tranches noted earlier (implying, a revenue recognition period of approximately nine years). The patents that would have been presented if the trial had gone ahead had remaining lives of two and a half years and five years respectively. The cash and receivable due for the IP licence will give rise to a significant deferred income balance of approximately £54.0m in the Group's Financial Statements that will be recognised as revenue in line with the nine-year period noted above. Revenue from the IP licence in H2 FY2022/23 is expected to be approximately £3.0m and then £6.0m each year thereafter until the deferred income has been recognised in full.

The costs of the litigation (approximately £47.0m) will be expensed in full in FY2022/23 as a standalone cost reflecting the fact that the litigation itself has now ceased. There will also be a one-off interest charge of approximately £4.7m linked to the Group's loan notes that were executed in July 2021, based on a successful conclusion to the Samsung litigation.

Nanoco's accumulated tax losses will be available to offset any tax impacts from the above subject to final computations, normal UK rules restricting the utilisation of losses in any one year, and any overseas withholding tax. Depending on forecasts of the possible utilisation of tax losses in future financial years, a deferred tax asset may be recognised in the Group's Financial Statements. It is expected that net cash tax payable in respect of FY2022/23 will be modest. The final tax position will also depend on any losses in the organic business in the year (excluding the Samsung agreements) as well as any beneficial impact of both the UK's R&D tax credit and Patent Box regimes.

The Group expects to have net negative distributable reserves in a number of subsidiary companies and in the parent company itself after the impact of the transactions noted above. The Board has therefore decided to review options for its future capital structure prior to the receipt of the second tranche of proceeds around February 2024 in order to facilitate a possible return of funds to shareholders.

## Settlement validates Nanoco's core-IP and refocuses it on the growing organic business

Nanoco's successful settlement of its long-running Samsung litigation will now permit its share price to refocus on the value of its core IP (against which it will remain vigilant to other potential infringement activity, as well as opportunities to pro-actively deliver new licence agreements) and the growing success of its organic business. Importantly in this respect, the Settlement does not encumber the Group's operational freedoms, which remain open in all of its markets, territories, products and material types.

Given the highly uncertain timing of any final settlement with Samsung, the past years have seen the Group reducing its installed cash cost base from over £12.0 million in FY2018/19 to around £4.0 million for FY2022/23, while retaining its core capabilities and building its revenue generating potential. Amongst other things, it achieved this through closure of the Group's Manchester facilities and relocation to Runcorn, which was delivered on budget and slightly ahead of time by focusing on its 'dot only' strategy. The centralising of its operations plays to Nanoco's technological expertise and creates a number of operational and team benefits, which are now being supported through recruitment of additional production and associated personnel. Following the recently completed decommissioning and dilapidations, the Group's annualised installed cost base is expected to reduce by around £0.4 million (net) after savings are partly offset by inflationary labour and raw material increases and new staff hires. Management's focus now remains on delivering a production-ready facility and validated materials in anticipation of customer orders in CY2023.

## Interim results expected to be released on 28 March 2023

Nanoco expects to announce Interim Results for the half year ended 31 January 2023 on 28 March 2023. While aspects of the Settlement are likely to be considered and discussed in the Board's accompanying statement, its financial impact will only be reflected the Group's second half statement for FY2022/23 and onwards.

The half-year witnessed continued successful delivery of technical milestones for the Group's European Electronics and Asian Chemical customers. It also received increased demand for volumes of development materials and presently remains on track to deliver two fully validated production materials for use in infra-red sensing. As such, revenue remained comfortably in line with the Board's expectations for the period.

Active cost management is also delivering similarly in line and, as a result of the factors detailed above, combined with FX tailwinds, the Adjusted EBITDA loss for the year to end-July 2023 is now expected to be narrower than (and therefore ahead of) the Board's previous expectations. Net cash consumption in the period was £0.8m, leaving a cash balance of £6.0m.

## Settlement's transformational outcome positions Nanoco to seize true opportunity of its IP

Friday's settlement should be considered transformative for Nanoco, in that despite recognising the inherent value and long-term potential of its IP, it has been forced to considerably limit potential outgoings in recent years. Given that its average net monthly burn rate has recently been reduced to under £0.2m, pre-Settlement cash of £6.0m provided a runway out to the beginning of 2H FY2024/25. Although prudence remains the Board's watchword, given the extent of new cash-in-hand that will become available from early March 2023, it is realistic to expect otherwise deferred expenditure on a number of projects in both Display (CFQD® quantum dots) and Electronics (where it sees potential to deliver significant value once in commercial production) to be ramped up as the Group can approach business development opportunities with increased confidence. Shareholders now await such details from Nanoco's Board, although TPI recognises opportunity to direct such near-term investment in anticipation of creating significant new revenue generating potential, while also rewarding them through distribution of any surplus:

- **Display (CFQD® quantum dots)** – By expanding its display commissioned, investing in the scaling-up of existing commercial production of material at the Runcorn facility/client R&D services, and also budgeting its internal research to extend the Group's patent library/technical understanding, Nanoco will position itself to take advantage of any broadening in the adoption of non-toxic quantum dots by global display manufacturers as the opportunity arises. Having already demonstrated QD can also be tuned for use in a variety of different media with adjustment of the surface ligands, opening them up to several different form factors and applications (including OLED/µLED colour conversion, the incorporation of CFQD® quantum dots directly within the OLED emitting device and even a proposition for optical security tagging), internal research could be focussed in leading-edge development.

- **Electronics** – Operational expansion could target reinforcement of Nanoco's dominance in the crafting of quantum dot and nanoparticle solutions, enabling delivery of unique products into the international life science research, pharmaceutical development, and routine clinical arenas. The Group's CMOS® Image Sensors and VIVODOTS® nanoparticles represent a new class of material that have potential to be applied in a range of techniques. Having moved from a single customer/single product in early 2018 to being engaged with seven customers presently while working with twelve distinct materials/wavelength combinations today, it already finds itself strongly positioned. A number of materials are progressing from development towards final validation, which is the last step before commercial production orders are placed. The Group's European and Asian customers participate in very large global markets wherein final customer adoption of QD sensing technology would lead to significant revenue opportunity. This will build significantly upon the Group's global reputation, while new investment could deliver capacity necessary to secure and support customer relationships.

## Firm intention to deliver a "material return of capital to shareholders"

Friday's news release underlined Nanoco's firm intention to deliver a "material return of capital to shareholders." The Group will receive gross proceeds of US$150 million (c.£125 million), of which US$65m is for the IP Licence agreement and US$85m for the IP Sale agreement, which are payable in two equal tranches by 5 March 2023 and by 3 February 2024. Of this, Nanoco expect to retain over 60% (over US$90m), having deducted legal and litigation funding costs (which have first claim on the proceeds) of US$47m. and c.£4.7m linked to the Group's loan notes that were executed in July 2021, based on a successful conclusion to the Samsung litigation. Retaining in excess of £40m in carried forward losses, the Board is confident that its remaining tax liability from the Settlement will be modest, leaving it with cash plus promised cash representing almost 90% of the Group's current market capitalisation.

In the absence of a formal Board decision with respect to how it will direct available funding in coming years, however, shareholders remain uncertain as to the extent of the proposed distribution, either in the form of special dividends and/or the initiation of a share buyback programme. Recognising the management's confidence in its technological capabilities/validated IP and its ability to exploit the longer-term opportunity these present, it would be realistic to expect a substantial proportion of the newly secured cash to be reserved and then directed toward, amongst other things, enhancing and automating production capacity, while expanding marketing to what is a relatively limited number of very large existing and potential customers in anticipation of delivering a self-sustaining business model, possibly also putting aside a reasonable cash reserve to ensure rapid follow-up of all/any further IP infringements, without recourse to investors or assuming further leverage. At this point, TPI estimates that a remaining surplus in the range of £45m could be made available for distribution to shareholders this year and next.

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