



13 September 2017

Surgical Innovations Group plc
("SI" or the "Group")

Half-year Report
Interim results for the six months ended 30 June 2017

Surgical Innovations Group plc (AIM: SUN), the designer, manufacturer and distributor of innovative medical technology for minimally invasive surgery, reports strong financial results for the six month period ended 30 June 2017, and good progress on the integration of Elemental Healthcare Limited ('Elemental'), which was acquired on 1 August 2017.

Highlights:

- Revenues up 14.1% to £3.47m (2016H1: £3.04m) led by strong OEM performance and UK sales growth
- Gross margin improvement to 38.0% (2016H1: 26.6%, 2016 full year: 33.8%)
- Operating margin up to 8.8% (2016H1: 1.0%, 2016 FY: 7.7%)
- Profit before taxation of £0.30m (2016H1: loss of £0.06m, 2016 full year: £0.28m)
- Increased net cash at bank of £1.16m (31 Dec 2016: £0.72m)
- More demanding regulatory environment across the industry
- Transformational acquisition and board appointments on 1 August 2017

Executive Chairman of SI, Nigel Rogers, said:

"I am pleased to report that SI has delivered financial results at the upper end of our range of expectations in the first half of the year, with strong growth in revenues and profits, and an increase in net cash balances. Trading in the second half of the year to date has been satisfactory, and continues to meet the board's expectations.

"Following the recent acquisition of Elemental Healthcare Limited and the resulting appointments of Adam Power and David Marsh to the board, we also have a wider field of vision for the identification of further potential acquisition opportunities, and additional management capacity for execution and integration of any future transactions.

"Accordingly, we have ambitious plans for the future development of the Group's activities, and confidence in our combined ability to deliver further success."

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Surgical Innovations Group plc

Chairman's Statement

For the six month period ended 30 June 2017

I am pleased to report that SI has delivered financial results at the upper end of our range of expectations in the first half of the year, and has more recently completed a transformational acquisition adding scale, commercial expertise and deep industry experience to the strong operational capabilities of the Group.

Strategy

The Group specialises in the design, manufacture, sale and distribution of innovative, high quality medical products, primarily for use in minimally invasive surgery. Our product and business development is guided and supported by a key group of nationally and internationally renowned surgeons across the spectrum of minimally invasive surgical activity.

We design and manufacture and source our branded port access systems, surgical instruments and retraction devices which are sold directly in the UK home market through our newly acquired subsidiary, Elemental, and exported widely through a global network of trusted distribution partners. Many of our products in this field are based on a "resposable" concept, in which the products are part re-usable, part disposable, offering a high quality solution at a cost that is competitive against fully disposable alternatives.

Elemental also has exclusive UK distribution for a select group of specialist products employed in laparoscopy, bariatric and metabolic surgery, hernia repair and breast reconstruction.

In addition, we design and develop medical devices for carefully selected OEM partners, and have also collaborated with a major UK industrial partner to provide precision engineering solutions to complex problems outside the medical arena.

We aim for our brands to be recognised and respected by healthcare professionals in all major geographical markets in which we operate.

Financial Overview

Revenues increased by 14.1% to £3.47m (2016H1: £3.04m), led by strong call off of OEM products which increased by more than 60% to £0.86m (2016H1: £0.53m). Revenues from SI branded products was steady at £2.48m (2016H1: £2.47m), with some growth in the UK and Europe. Revenues from the US and Latin America were slightly lower than the corresponding period last year, which included significant initial stock orders from two new distributors although prospects here for the second half of the year remain positive. Gross margins continued to track within target range at 38.0% of revenues (2016 FY: 33.8%).

Other operating expenses increased by £0.24m to £1.01m reflecting additional engineering manpower in new product introduction, quality and regulatory compliance. The net operating profit for the period was £0.30m (2016H1: £0.03m) at an operating margin of 8.8%. Net profit before taxation amounted to £0.30m against a net loss before taxation of £0.06m in the corresponding period last year.

The Group recorded a corporation tax credit of £nil (2016 FY: £0.44m) and a deferred tax credit of £nil (2016 FY: £nil). The Group has substantial tax losses and continues to review the extent to which a deferred tax asset should be recognised based on the estimated future taxable profits of the Group. No deferred tax asset has been recognised in previous periods, and this remains under review for the current year. The tax credit of £0.44m in the year ended 31 December 2016 related to claims for enhanced Research and Development in respect of 2014 and 2015. The Group are in the process of preparing an enhanced Research and Development claim for 2016, this will depend on the amount current year tax losses that can be elected to exchange for cash, if any.

The net profit and total comprehensive income for the period amounted to £0.30m (2016 full year: £0.72m), resulting in net earnings per share of 0.06p (2016 FY: 0.15p).

Net investment in working capital was virtually unchanged at £2.05m (31 December 2016: £1.94m) with operating cash conversion of 102% of EBITDA (2016: 202%).

Net cash flow from operating activities amounted to £0.85m (2016 FY: £2.85m), stated before outflows of £0.43m on investing activities (2016: £0.78m) including instalments due for the acquisition of the laparoscopic assets and business activities of Surgical Dynamics Limited in November 2016. At the end of the period, the Group had available cash at bank of £1.19m, and was in full compliance with all financial covenants. Total net cash resources, taking into account finance leases outstanding, increased to £1.16m (31 December 2016: £0.72m).

Product development and the regulatory framework

The speed of delivery of new products through our New Product Introduction (“NPI”) programme has been subject to additional constraints arising from the more demanding regulatory environment inherent across the industry in the past several months. We fully support the initiatives of the MHRA (Medicine and Healthcare products Regulatory Agency) and others to engender greater transparency and vigilance in ensuring products authorised for use have been designed, manufactured and tested in a sufficiently rigorous manner.

In particular, we endorse new guidelines published in March 2017 to ensure that products made under Own Brand Label arrangements by third parties, who may be domiciled in a less heavily regulated environment, are the full responsibility of the domestic reseller as “virtual manufacturer.” The practical effect of these guidelines has been to on-shore the regulatory burden for such arrangements, which may be a significant factor in the apparent shortage of resources available to Notified Bodies to meet ongoing service level requirements of domestic manufacturers in a timely manner.

During the first half of the year, we have reacted to these pressures by effecting a change of Notified Body responsible for regulating our affairs, whilst also preparing for a US FDA audit visit to our Leeds facility for the first time in several years, which was successfully completed early in July.

These changes have necessitated a modest increase in our operating overheads in this area, and also caused some delays to product development programmes. In the first half of the year, we progressed from beta trials to full product release of the initial stages of the YelloPort Elite port access range, and further follow-on products are now expected to be available around the end of the year. We have also met with added complexity in transferring and expanding our range of single use instruments arising from the acquisition of the laparoscopic business and assets of Surgical Dynamics Limited in November 2016. We have transferred all of the manufacturing equipment to Leeds and expect application to be made for CE mark at the end of 2017, with beta trials of the products commencing in early 2018.

Acquisition of Elemental Healthcare Limited

On 1 August 2017, we completed the acquisition of Elemental Healthcare Limited, a leading distributor of innovative medical products to the NHS and UK private hospitals. These products span a range of specialised clinical disciplines covering laparoscopy (including SI branded products), bariatric and metabolic surgery, hernia repair, and breast and abdominal wall reconstruction.

In the year ended 31 March 2017, Elemental reported revenues of £6.5m and an adjusted operating profit of £1.10m.

Consideration for the transaction amounted to £9.14m including the issue of shares to the vendors of £1.88m at 3p per share. The remainder was financed by an institutional placing of £5.5m at a price of 3p per share, and partial drawdown of a new £3.0m facility with Yorkshire Bank of five years duration.

The initial reaction of customers and other stakeholders to Elemental joining the Group has been favourable, and integration of the enlarged Group’s business is progressing very well.

Board composition

On completion of the acquisition of Elemental we were delighted to welcome the former owners, Adam Power and David Marsh, to the board of the enlarged Group. Both Adam and David have a wealth of experience in the medical device industry in the UK and overseas, and bring a base of knowledge and contact network which reflects their past successes in introducing new and innovative products to market over many years.

In addition to their ongoing leadership of Elemental, Adam has been appointed as Group Development Director and David as Group Commercial Director, and we look forward to their full participation in the future direction of the Group's activities.

Current trading and outlook

Trading in the second half of the year to date has been satisfactory, and continues to meet the board's expectations.

Our primary goal is to continue to gain market share by encouraging our customers and distributors to value the benefits of our high quality "resposable" products in competition with single use equivalents, and to introduce and encourage adoption of innovative new solutions. We also see opportunities to continue to develop even stronger relationships with our key partners to achieve ever improving patient outcomes at an affordable cost to healthcare providers.

Following the recent acquisition and expansion of the board, we also have a wider field of vision for the identification of further potential acquisition opportunities, and additional management capacity for execution and integration of any future transactions.

Accordingly, we have ambitious plans for the future development of the Group's activities, and confidence in our combined ability to deliver further success.

Nigel Rogers

Executive Chairman

13 September 2017

**Unaudited consolidated income statement
for the six months ended 30 June 2017**

	Notes	Unaudited six months ended 30 June 2017 £'000	Unaudited six months ended 30 June 2016 £'000	Audited Year Ended 31 December 2016 £'000
Revenue	2	3,467	3,037	6,089
Cost of sales		(2,151)	(2,228)	(4,029)
Gross profit		1,316	809	2,060
Other operating expenses		(1,011)	(775)	(1,591)
EBITDA *		831	497	1,408
Depreciation and amortisation		(526)	(463)	(939)
Operating profit		305	34	469
Finance costs		(4)	(92)	(192)
Finance income		-	-	1
Profit/(loss) before taxation		301	(58)	278
Taxation credit	3	-	304	438
Profit and total comprehensive income for the period attributable to the owners of the parent		301	246	716
Earnings/(loss) per share				
Basic	4	0.06p	0.05p	0.15p
Diluted	4	0.06p	0.05p	0.14p

* EBITDA is earnings before interest, depreciation, amortisation and exceptional items.

**Unaudited consolidated statement of changes in equity
for the six months ended 30 June 2017**

	Share capital £'000	Share premium £'000	Capital Reserve £'000	Retained earnings £'000	Total £'000
Balance as at 1 January 2017	5,334	2,339	329	(2,164)	5,838
Issue of shares	10	26	-	-	36
Employee share-based payment charge	-	-	-	9	9
Total - Transaction with owners	5,344	2,365	329	(2,155)	5,883
Profit and total comprehensive income for the period	-	-	-	301	301
Unaudited balance as at 30 June 2016	5,344	2,365	329	(1,854)	6,184

**Unaudited consolidated balance sheet
as at 30 June 2017**

	Unaudited 30 June 2017 £'000	Unaudited 30 June 2016 £'000	Audited 31 December 2016 £'000
Assets			
Non-current assets			
Property, plant and equipment	1,426	1,622	1,579
Intangible assets	1,547	1,357	1,597
	2,973	2,979	3,176
Current assets			
Inventories	1,622	1,282	1,496
Trade receivables	1,014	892	1,098
Other current assets	279	587	289
Cash and cash equivalents	1,188	2,214	775
	4,103	4,975	3,658
Total assets	7,076	7,954	6,834
Equity and liabilities			
Equity attributable to equity holders of the parent company			
Share capital	5,344	4,880	5,334
Share premium account	2,365	1,654	2,339
Capital reserve	329	329	329
Retained earnings	(1,854)	(2,645)	(2,164)
Total equity	6,184	4,218	5,838
Non-current liabilities			
Borrowings	-	2,788	-
Obligations under finance leases	2	17	8
	2	2,805	8
Current liabilities			
Trade and other payables	386	270	337
Obligations under finance leases	29	128	45
Accruals	475	382	606
	890	931	988
Total liabilities	892	3,736	996
Total equity and liabilities	7,076	7,954	6,834

**Unaudited consolidated cash flow statement
for the six months ended 30 June 2017**

	Unaudited six months ended 30 June 2017 £'000	Unaudited six months ended 30 June 2016 £'000	Audited year ended 31 December 2016 £'000
Cash flows from operating activities			
Operating profit	305	34	469
Adjustments for:			
Depreciation of property, plant and equipment	265	258	510
Amortisation of intangible assets	261	205	429
Share-based payment charge	9	12	23
Grant income	-	(10)	(10)
Foreign Exchange	(17)	76	65
Operating cash flows before movement in working capital	823	575	1,486
Decrease in inventories	(234)	659	797
Decrease in current receivables	94	449	178
Increase/(decrease) in trade and other payables	168	245	(61)
Cash generated from operations	851	1,928	2,400
Taxation received	-	-	531
Interest paid	(6)	(48)	(86)
Net cash generated from operating activities	845	1,880	2,845
Cash flows from investing activities			
Payments to acquire property, plant and equipment	(112)	(52)	(161)
Acquisition of intangible assets	(210)	(201)	(440)
Acquisition of Surgical Dynamics assets and laparoscopic business	(105)	-	(182)
Net cash (used in) investing activities	(427)	(253)	(783)
Cash flows from financing activities			
Repayment of bank loan	-	(200)	(2,000)
Repayment of obligations under finance leases	(22)	(113)	(198)
Net cash (used in) financing activities	(22)	(313)	(2,198)
Net increase in cash and cash equivalents	396	1,314	(136)
Cash and cash equivalents at beginning of period	775	976	976
Effective exchange rate fluctuations on cash held	17	(76)	(65)
Net cash and cash equivalents at end of period	1,188	2,214	775
Analysis of net borrowings:			
Cash at bank and in hand	1,188	2,214	775
Bank loan	-	(1,788)	-
Loan notes 2017	-	(1,000)	-
Obligations under finance leases	(31)	(145)	(53)
Net cash/(debt) at end of period	1,157	(719)	722

Notes to the Interim Financial Information

1. Basis of preparation of interim financial information

The interim financial information was approved by the Board of Directors on 12 September 2017. The financial information set out in the interim report is unaudited.

The interim financial information has been prepared in accordance with the AIM Rules for Companies and on a basis consistent with the accounting policies and methods of computation as published by the Group in its annual report for the year ended 31 December 2016, which is available on the Group's website.

The Group has chosen not to adopt IAS 34 Interim Financial Statements in preparing these interim financial statements and therefore the interim financial information is not in full compliance with International Financial Reporting Standards as adopted for use in the European Union.

The financial information set out in this interim report does not constitute statutory financial statements as defined in section 434 of the Companies Act 2006. The figures for the year ended 31 December 2015 have been extracted from the statutory financial statements which have been filed with the Registrar of Companies. The auditor's report on those financial statements was unqualified and did not contain a statement under sections 498(2) and 498(3) of the Companies Act 2006.

2. Segmental reporting

Information reported to the Board and for the purpose of assessing performance and making investment decisions is organised into three operating segments. The Group's operating segments under IFRS 8 are as follows:

- **SI Brand** - the research, development, manufacture and distribution of SI branded minimally invasive devices.
- **OEM** - the research, development, manufacture and distribution of minimally invasive devices for third party medical device companies through either own label or co-branding.
- **PE-** (Precision Engineering formerly Industrial) the research, development, manufacture and sale of precision engineering applications.

The measure of profit or loss for each reportable segment is gross margin less attributable amortisation of product development costs.

Assets and working capital are monitored on a Group basis, with no separate disclosure of asset by segment made in the management accounts, and hence no separate asset disclosure is provided here. The following segmental analysis has been produced to provide reconciliation between the information used by the chief operating decision maker within the business and the information as it is presented under IFRS.

Six months ended 30 June 2017 (unaudited)	SI Brand	OEM	PE	Total
	£'000	£'000	£'000	£'000
Revenue	2,478	861	128	3,467
Result				
Segment result	720	276	59	1,055
Unallocated expenses				(750)
Profit from operations				305
Finance costs				(4)
Finance income				-
Profit before taxation				301
Tax				-
Profit for the period				301

Included within the segment/operating results are the following significant non-cash items:

	SI Brand	OEM	PE	Total
Six months ended 30 June 2016 (unaudited)	£'000	£'000	£'000	£'000
Amortisation of intangible assets	198	63	-	261

Six months ended 30 June 2016 (unaudited)	SI Brand	OEM	PE	Total
	£'000	£'000	£'000	£'000
Revenue	2,470	526	41	3,037
Result				
Segment result	503	74	27	604
Exceptional items				-
Unallocated expenses				(570)
Profit from operations				34
Finance costs				(92)
Finance income				-
Loss before taxation				(58)
Tax				304
Profit for the period				246

Included within the segment/operating results are the following significant non-cash items:

	SI Brand	OEM	PE	Total
Six months ended 30 June 2016 (unaudited)	£'000	£'000	£'000	£'000
Amortisation of intangible assets	142	63	-	205

	SI Brand	OEM	PE	Total
Year ended 31 December 2016 (audited)	£'000	£'000	£'000	£'000
Revenue	4,664	1,219	206	6,089
Result				
Segment result	1,210	285	136	1,631
Unallocated expenses				(1,162)
Profit from operations				469
Finance income				1
Finance costs				(192)
Profit before taxation				278
Tax				438
Profit for the period				716

Included within the segment/operating results are the following significant non-cash items:

	SI Brand	OEM	Industrial	Total
Year ended 31 December 2016 (audited)	£'000	£'000	£'000	£'000
Amortisation of intangible assets	304	125	-	429

Unallocated expenses include those costs that cannot be split between segments and which are not separately analysed in the management accounts including concept department, sales and marketing, and head office overheads.

Geographical analysis

	Unaudited six months ended 30 June 2017 £'000	Unaudited six months ended 30 June 2016 £'000	Audited year ended 31 December 2016 £'000
United Kingdom	1,322	863	1,920
Europe	719	663	1,287
US	1,047	1,031	1,876
Rest of World	379	480	1,006
	3,467	3,037	6,089

Revenues are allocated geographically on the basis of where revenues were received from and not from the ultimate final destination of use.

3. Taxation

Current Tax

The Group is in the process of preparing a claim for enhanced Research and Development, as this claim is contingent no current tax has been recognised for the period ended 30 June 2017 (Full year 2016: £438,000). The credit in respect of the year ended 31 December 2016 was for claims made for 2014 and 2015 and was dependent on electing to exchange tax losses for a cash refund.

Deferred Tax

At the balance sheet date, the Group has unused tax losses of £21.7 million available for offset against certain future profits. The timing differences in the fixed assets has given rise to a deferred tax liability of £93,000 in addition a deferred tax asset relating to brought forward losses has been used to offset this liability. No deferred tax asset has been recognised in respect of the remaining £21.2 million, due to the estimate of future taxable profits in excess of those arising from the reversal of deferred tax liabilities.

4. Earnings per share

	Unaudited six months ended 30 June 2017	Unaudited six months ended 30 June 2016	Audited year ended 31 December 2016
Earnings per share			
Basic	0.06p	0.05p	0.15p
Diluted	0.06p	0.05p	0.14p

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of shares in issue. Diluted earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the diluted weighted average number of shares in issue.

The Group has one category of dilutive potential ordinary shares being share options issued to Directors and employees. The impact of dilutive potential ordinary shares on the calculation of weighted average number of shares is set out below.

	Unaudited six months ended 30 June 2017 '000s	Unaudited six months ended 30 June 2016 '000s	Audited year ended 31 December 2016 '000s
Weighted average number of ordinary shares	533,835	486,539	487,924
Dilutive effect of share options in issue	11,006	1,294	6,077
Diluted weighted average number of ordinary shares	544,841	487,833	494,001

5. Related Party Transaction

Getz Bros and Co (BVI) Inc. ("Getz") is a substantial shareholder of Surgical Innovations Group plc. Getz is the ultimate beneficial owner of Asia Cardiovascular Products Limited ("ACP").

ACP acts as the master distributor for SI in the Far East. During the six months ended 30 June 2017, SI invoiced ACP £180,000 for products and as at 30 June 2016 there was an amount owing to the Group of £97,000.

Director's fees of £5,000 were paid to Hardy Transaction Management Ltd. There is no controlling party of Surgical Innovations Group plc.

6. Interim Report

This interim report is available at www.sigroupplc.com.