science group

24 January 2019

Science Group plc
("Science Group" or "Group" or "Company")

Corporate Strategic Review

On 21 September 2018, the Board announced a review of the Group's corporate strategy. Since that time, a wide-ranging assessment of opportunities for the Group has been undertaken. The scenarios considered by the Board included a formal sale process ("FSP") which, as set out in the announcement on 14 December 2018, the Board concluded that, in the current market, was unlikely to deliver the most attractive outcome for shareholders and was terminated. The Board has now completed the Strategic Review.

Trading Update

Trading to the end of December 2018 continued in line with the Board's expectations.

The preliminary results for the year ended 31 December 2018 are anticipated to be released in early March.

Shareholder Liquidity

From discussions with major shareholders, the Board believes that it is not the intention of any of the top five holders, which in aggregate account for over 70% of the issued share capital of the Company, to reduce their holdings and that material dilution of current shareholdings would not be welcomed. While the Board is pleased that the Company benefits from a supportive shareholder base, the lack of liquidity creates a market inefficiency which may impact the valuation of the Group and the tightly held equity structure may render the raising of capital through the equity markets less attractive for the Company.

Share buy-back programmes will continue to provide some share liquidity and the Board anticipates continuing the programme announced on 19 April 2018. However, it is recognised that this may in fact exacerbate share illiquidity but, on balance, the Board considers that reducing volatility from small share trades is in the best interests of all shareholders.

Capital Resources

At 31 December 2018, the Group's gross cash balance exceeded £21 million and the Group's term loan was £12.75 million. The loan, which is secured on the Group's freehold properties, expires in 2026 and the interest rate is fixed via a swap instrument. Subject to not exceeding a net debt level of £10 million, there are no operating covenants on the loan and, in the event that covenants were to be breached, the Company has a 6 month remedy period. This risk-mitigated, long-term debt structure provides attractive terms to the Group and the Board is considering increasing this loan, subject to lender terms, up to the maximum 70% loan-to-property value limit (based on a conservative valuation model).

The Board also recognises that the Group could potentially support additional debt leverage and therefore may in the future consider this option to increase access to capital to facilitate

the Group's strategy. However, risk management will remain a key aspect of debt financing considerations and there is no certainty that additional facilities can be obtained on terms acceptable to the Board.

In addition to the debt facilities, the Board has authority, subject to renewal at the Annual General Meeting, to undertake equity fund raisings equivalent to approximately 10% of the issued share capital. The Company currently also holds 2.0 million Treasury Shares, acquired through the buy-back programme, which are available for issue and not subject to pre-emption. In aggregate the Board could therefore issue up to 6 million shares to raise capital, if required and subject to investor demand, although, as referenced above, equity capital is currently considered by the Board to be less attractive than debt financing.

In terms of the allocation of the Group's cash resources, the Board did consider both a special dividend and a tender offer, but concluded that the former was unattractive to some shareholders and the latter would further reduce the liquidity of the Company's shares unless the major shareholders participated in any such tender offer. Furthermore, such return of capital would restrict the potential to pursue strategic growth opportunities for the Group.

Corporate Strategy

The Strategic Review concluded that the primary use of the capital resources of the Company should be to increase the scale of the Group through acquisitions and organic investment. For such a strategy to be effective, the Board considers it essential that resources are readily accessible in order to be able to successfully execute transactions in a timely and competitive manner. As outlined above, the Board has evaluated, and continues to consider, the most attractive sources of capital to enable this strategy.

The Board will continue to seek organic investment opportunities and acquisitions to build on the current science and technology-based services business. The geographical focus for these add-on acquisitions will be UK, North America and Europe. These potential acquisitions would follow a similar post-acquisition integration model to that implemented previously.

However, the Board has decided to broaden the target criteria in order to deploy the Group's capital and management resources to enhance returns for shareholders. As a result, larger acquisitions will be considered which may or may not have any synergies with, the Group's existing operations, if the Board considers that value can be created. Furthermore, the Board will consider opportunities to acquire a major shareholding rather than make a full acquisition, if appropriate.

There is no certainty that acquisition opportunities that satisfy the Board's requirements can be identified or that transactions can be completed on acceptable terms. However, the Board will now adopt a wider mandate upon which to deploy its resources.

Freehold Property

The Board considers the working environment to be very important to attract and retain high calibre staff in a competitive employment market. The Group's freehold properties provide excellent facilities which are appreciated by employees and clients.

However, as part of the Strategic Review, it was appropriate that the Board consider the financial merits of owning freehold property and consider the relevance of a sale and leaseback of the Group's properties. The conclusion was that

1. The operational benefits derived from property ownership are significant in terms of the flexibility to rapidly reconfigure the office and laboratory facilities as required, without dilapidations or other charges typically imposed by landlords;
2. The ability to secure debt on the freehold properties provides attractive long-term capital with lower risk terms than would typically be available on a traditional cash flow debt model;
3. The freehold property model is financially beneficial, reducing operating costs at a consolidated Group level; and
4. The strong asset base provides reassurance to customers, employees and shareholders.

The Board also assessed the merits of extracting the Harston Mill property out of the Sagentia operating business, a legacy issue. While this will incur a one-off tax charge and cash outflow of around £2 million, the Strategic Review concluded that the long-term benefits from separation of the property from the operating business, including the longer-term flexibility and greater transparency for investor valuation, justified the transfer of Harston Mill to a separate company. It is anticipated that the existing subsidiary, Sagentia Technology Advisory Limited, (to be renamed) will be used for this purpose which should enable the carried-forward tax losses in that business to be utilised, recovering a proportion of the initial tax charge over future years.

Group Structure

The Strategic Review highlighted the operational and financial benefits of the freehold property assets but also the challenge for investor valuation of a services business.

It is clear that the operating and reporting structure of the Group should evolve to provide greater transparency of both the performance of the operating business and the value of the Group's significant freehold property assets. In summary, the property companies should act as landlord to the operating businesses, with arms-length, long-term lease arrangements, at market rates, between the operating and property subsidiaries of the Group. Similarly, Group/PLC costs should be reported separately to differentiate the operating and corporate costs within the business.

As a result, for the year ending 31 December 2019, financial reporting will reflect this model although it is not anticipated that this structure will be established until the second half of the year.

Brexit

The uncertainty related to Brexit progressively increased through the period of the Strategic Review. Since this event has an impact for most international businesses, it is appropriate to note some examples of implications for the Group.

One consequence of Brexit to UK based organisations providing R&D services to some EU clients is that tax credits received by clients on R&D work may no longer be available if services are provided from the UK. While this is currently only relevant to a small number of projects

within Science Group, the Board is reviewing options to be able to continue to service these clients effectively and competitively. In contrast, some parts of the Group are noticing an increased initial enquiry rate related to Brexit, particularly the Group's businesses providing regulatory services to UK and European customers.

In summary, the consequences of Brexit remain uncertain, but it should be noted that there are political dynamics in other markets (eg USA) which may similarly impact the Group's clients in the year ahead. The Board is monitoring the Brexit debate, along with other external market factors, and will evolve the Group's business according to the outcome of the political process.

Summary

The Strategic Review has provided a framework for the Board to explore a wide-ranging agenda. The first conclusion is that the Group benefits from a strong financial base which provides a platform for both continuing the existing strategy and expanding the breadth of opportunities that the Board may explore.

It is also clear that greater transparency through separation of the operating businesses from the Group's freehold property assets, and identification of corporate costs, could be advantageous and enable the value of the Group's components to be more fully recognised.

In summary, the strong financial platform, supportive shareholder base and the broader strategic agenda creates an exciting and dynamic future for the Group's management and employees which in turn the Board believes should deliver value for the Company's shareholders.

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