RNS Number : 1348G
Surface Transforms PLC
30 September 2024

This information communicated within this announcement is deemed to constitute inside information as stipulated under the Market Abuse Regulations (EU) No. 596/2014 as it forms part of UK domestic law by virtue of the European Union (Withdrawal) Act 2018 ("MAR"), and is disclosed in accordance with the Company's obligations under Article 17 of MAR. Upon the publication of this announcement, this inside information is now considered to be in the public domain.

Surface Transforms plc
("Surface Transforms" or the "Company")

Interim results for the six months ended 30 June 2024

Surface Transforms (AIM: SCE) manufacturers of carbon fibre reinforced ceramic automotive brake discs, announces its unaudited interim results for the six months ended 30 June 2024 ("H1-2024").

Financial highlights:

- Revenue increased 58% to £4.7m (H1-2023: £2.9m)
- Gross profit margin of 56% (H1-2023: 61%) includes a larger proportion of lower margin volumes and increased outsourcing
- Operating loss £7.4m (H1-2023: £5.6m (including exceptional items))
- Loss before tax £7.6m (H1-2023: £5.6m)
- £8.9m equity placing and open offer proceeds (net of costs) completed to support working capital requirements
- Cash as at 30 June 2024 was £5.0m (H1-2023: £4.5m)

All H1-2023 figures have been restated for the revised interpretation of IFRS 15 relating to system integration services and described in detail in the 2023 Annual Report (page 81)

Q3 highlights:

- Andrew Kitchingman appointed as Chair on 16 September 2024
- Expected Q3 revenues of £2.7m improved over Q2 but significantly behind plan
- Yield improved during Q3 but is behind Q3 average yield target of 85%. The improving trend means our run rate in recent weeks is broadly achieving Q3 average target
- Customers remain supportive and encouraged with our improvements in capacity and output
- Yield improvement benefits being partially offset by new consequential downstream process losses, effectively delaying the full benefits of the yield improvements
- Q4 revenues are expected to be approximately £3.5m, 40% down on plan. Expected revenues for the full year of approximately £11m (with no engineering revenues prudently assumed) will be significantly behind current market guidance of £17.5m
- Investments in capacity upgrade projects, improving yield and supporting working capital is consuming our cash headroom
- We are managing cash and working capital carefully and reviewing all funding options to improve our cash flow

CEO statement

2024 continues to be a year with contradictory positions. Real progress on scaling up and delivering growth is being made, however the pace of growth is not as we had anticipated.

Output and revenue have improved post period end, with volumes having more than doubled during Q3 compared to Q2. The key drivers for achieving this growth have been the delivery of capacity upgrade projects and process/equipment refinements which are leading to increases in overall manufacturing yield.

The rate of growth in output and revenue growth is however slower than we had planned. H2 revenues are expected to be circa 40% down on plan, excluding engineering revenues. The key drivers that are resulting in a slower pace of growth are delays to enhancing capacity and also yield improvement projects.

Capacity upgrades are the largest contributor to our gap in output growth and are taking longer to implement than planned, further details provided in the section below.

Manufacturing yield projects are also slowing the pace of output growth but to a much lower degree than capacity upgrades. Yield improvement projects are being delivered, but we are seeing the benefits from these projects being partially offset by consequential downstream process losses. These new consequential losses are easier to resolve and are being addressed. Nonetheless, they have the effect of delaying the benefits of the yield improvements.

Our customers continue to work closely with us. They understand the challenges of building capacity and achieving the required yields and are encouraged by what they are observing with the improving outputs and capacity. They are supportive as we work to improve the pace of growth further.

No engineering revenue (estimated value £1.7m) has been recognised to date, due to ongoing performance obligation assessments under IFRS 15. While customer development work continues to be delivered and invoiced as milestones are reached, revenue recognition is currently under review. We are actively collaborating with our advisors and auditors to determine when the necessary criteria for revenue recognition will be met.

Cash at June 30, 2024, stood at £5.0m however current levels at the end of Q3 are significantly reduced. Operational and working capital continues to consume cash as we deliver new capacity and increased output, but with a slower pace of revenue growth than we anticipated.

The Company is actively implementing strategies to accelerate the release of cash tied up in working capital, including ongoing discussions with key customers and suppliers to optimise payment terms.

New capacity update

Specific upgrade projects to our existing £20m revenue capacity manufacturing equipment are enhancing our current capacity. Our £50m manufacturing revenue programme has also introduced additional capacity across all but one process and is providing much needed resilience, by resolving a key risk from single points of failure. The remaining furnace, which is a capacity constraint, was planned for installation in Q4 2024 but has now moved to a mid-2025 installation.

We continue to draw down from our £13m ERDF loan and are progressing with the investment in the £75m manufacturing revenue capacity programme. First equipment is expected on site during 2025 and will continue throughout 2025 and into 2026.

Financial review

Revenue increased by 58% to £4.7m in the first half of 2024, primarily driven by growth in OEM customer sales. Gross profit margin declined to 56% due to increased outsourcing costs and product mix. There is no revenue recognised for work carried out on system integration services in the period.

Operating loss widened to £7.4m, primarily reflecting increased R&D spending at £7.2m in H1-2024 (£4.1m in H1-2023) to enhance manufacturing processes and improve yield. We are making progress in expanding production capacity to meet customer demand.

The Company has determined that it will not capitalise intangible assets at the half-year end and this decision is based on an ongoing assessment of the criteria set out in International Accounting Standard 38 "Intangible Assets" (IAS 38).

This has resulted in higher development expenses being recognised in the income statement leading to a larger loss for the period due to the increased expense burden. However, it is important to note that this decision does not reflect a change in the Company's long-term strategy and the potential value that will be generated by our R&D activities. The Company will continue to evaluate the appropriateness of capitalisation in accordance with IAS 38 in the full year financial statements.

Cash at June 30, 2024, stood at £5.0m, and we are implementing measures to improve working capital, particularly in terms of accelerating collection of trade receivables.

We continue with R&D to optimise our manufacturing operations, improve yield and reduce cost per disc. We believe these initiatives will position us for sustainable growth and profitability in the future. Planned capital expenditure of £3.4m occurred in the period, primarily aimed at delivering capacity. £3.4m of the ERDF facility which completed in December 2023, has been drawn down to support our capital investment programme.

Summary and outlook

While we are delivering new highs in terms of output and revenues in 2024, the pace of growth is significantly behind plan. Revenues in Q3 are expected to be significantly down on plan and we have revised our output and revenue plans for Q4 materially downwards. As a result, revenues for the full year are now expected to be circa £11m which is significantly lower than current market expectations of £17.5m.

The strategic objectives of building capacity and improving yield are being overcome, providing a stronger position to work from going forward; however, the delays in pace of growth are proving very difficult to anticipate correctly. Demand for our product remains strong and our customers continue to be supportive.

The impact of delays to the pace of growth has led to operational inefficiencies and cash constraints. We continue to manage cash flows carefully and are reviewing all available funding options to enhance our cash flow going forward.

Finally, I want to take the opportunity to thank employees for their dedication and commitment during another challenging period and to thank all shareholders for their support.

Board and Management

We were pleased to announce the appointment of Andrew Kitchingman as Non-Executive Chair, who brings a wealth of experience in corporate finance and public company governance. We are confident that his leadership will guide the Company towards continued success.

We would also like to express our sincere gratitude to David Bundred for his invaluable leadership as Chair over the past 12 years. Under David's leadership, the Company successfully navigated the development of our technology and secured significant contracts for its innovative carbon ceramic brake discs. His strategic vision and unwavering commitment to excellence were instrumental in positioning the Company as a key supplier in this rapidly growing industry. His dedication and expertise have left a lasting legacy.

A well-prepared leadership team can better navigate challenges and uncertainties. The board have approved an executive team leadership development programme, with the programme starting in Q4 and continuing into H1 2025. The goal is to enable the senior management team to scale operations efficiently and reliably by empowering our leaders with the skills to navigate challenges and drive continuous improvement.

Andrew Kitchingman, Chair, commented:

"These remain difficult times for the Company as it works to grow output and revenue. There remain numerous challenges and, following a period of further underperformance expected to continue through Q4, the Company will miss current market expectations by a significant margin. Cash is constrained at present, and we are working to evaluate all available options to improve this."

For enquiries, please contact:

Surface Transforms plc	**+44 151 356 2141**
Andrew Kitchingman, Chairman	
Kevin Johnson CEO	
Isabelle Maddock, CFO	
Zeus (Nominated Adviser and Joint Broker)	**+44 203 829 5000**
David Foreman / James Edis (Investment Banking)	
Dominic King (Corporate Broking)	
Cavendish Capital Markets (Joint Broker)	**+44 20 7220 0500**
Ed Frisby / Abigail Kelly (Corporate Finance)	
Andrew Burdis (ECM)	

About Surface Transforms

Surface Transforms plc. (AIM:SCE) develops and produces carbon - ceramic material automotive brake discs. The Company is the UK's only manufacturer of carbon - ceramic brake discs, and only one of two mainstream carbon ceramic brake disc companies in the world, serving customers that include major OEMs *in the global automotive markets.*

The Company utilises its proprietary next generation Carbon Ceramic Technology to create lightweight brake discs for high - performance road and track applications for both internal combustion engine cars and electric vehicles. While competitor carbon - ceramic brake discs use discontinuous chopped carbon fibre, Surface Transforms interweaves continuous carbon fibre to form a 3D matrix, producing a stronger and more durable product with improved heat conductivity compared to competitor products; this reduces the brake system operating temperature, resulting in lighter and longer life components with superior brake performance. These benefits are in addition to the benefits of all carbon - ceramic brake discs vs. iron brake discs: weight savings of up to 70%, longer product life, consistent performance, reduced brake pad dust and corrosion free.

The Company holds the London Stock Exchange's Green Economy Mark.

For additional information please visit www.surfacetransforms.com

Statement of total comprehensive income	**Six month ended 30-Jun-24**	***Restated**** **Six months ended 30-Jun-23**	**Year ended 31- Dec-23**
	Unaudited	**Unaudited**	**Audited**
	£'000	**£'000**	**£'000**
Revenue	4,653	2,937	7,312
Cost of Sales	(2,065)	(1,138)	(3,137)
Gross Profit	**2,588**	**1,799**	**4,175**
	56%	*61%*	*57%*
Other Income	7	7	16
Gross profit after other income	**2,594**	**1,806**	**4,191**
Administrative Expenses:			
Before research and development costs	(2,792)	(2,956)	(5,439)
Research and development costs	(7,195)	(4,126)	(9,676)
Impairment of fixed assets	-	-	(9,238)
Total administrative expenses	**(9,987)**	**(7,082)**	**(24,353)**
Operating loss before exceptional items	(7,393)	(5,276)	(20,162)
Exceptional items	-	(281)	(389)
Operating loss after exceptional items	**(7,393)**	**(5,557)**	**(20,551)**
Financial Income	57	2	5
Financial Expenses	(257)	(87)	(176)
Loss before tax	(7,592)	(5,642)	(20,722)
Taxation	539	643	1,163
Loss for the year after tax	**(7,054)**	**(4,999)**	**(19,559)**
Total comprehensive loss for the year attributable to members	(7,054)	(4,999)	(19,559)
Loss per ordinary share Basic and diluted	(1.06)p	(2.07)p	(7.92)p

**All H1-2023 figures have been restated for the revised interpretation of IFRS 15 relating to system integration services and described in detail in the 2023 Annual Report page 81*

	As at	***Restated ** * As at**	**As at**
	30-Jun-24	**30-Jun-23**	**31-Dec-23**
	Unaudited	**Unaudited**	**Audited**
	£'000	**£'000**	**£'000**
Non- current Assets			
Property, plant and equipment	19,449	18,864	16,017
Intangibles	22	3,413	-

Total non-current assets	**19,472**	**22,277**	**16,017**
Current assets			
Inventories	5,356	4,023	4,469
Trade receivables	2,939	1,970	1,702
Other receivables	1,530	2,508	1,161
Tax receivable	1,735	(643)	1,196
Contract fulfillment assets	1,708	737	1,342
Cash and cash equivalents	4,983	4,507	6,064
Total current assets	**18,251**	**13,101**	**15,934**
Total assets	**37,723**	**35,377**	**31,951**
Current liabilities			
Other interest-bearing borrowings	(294)	(211)	(211)
Lease liabilities	(374)	(348)	(357)
Trade and other payables	(5,671)	(4,470)	(5,649)
Total current Liabilities	**(6,339)**	**(5,028)**	**(6,217)**
Non-current liabilities			
Government grants	(168)	(181)	(174)
Lease liabilities	(1,805)	(1,290)	(1,429)
Other interest-bearing borrowings	(3,681)	(783)	(404)
Total non-current liabilities	**(5,654)**	**(2,255)**	**(2,007)**
Total liabilities	**(11,992)**	**(7,283)**	**(8,224)**
Net assets	**25,731**	**28,095**	**23,727**
Equity			
Share capital	13,021	2,417	3,521
Share premium	66,811	58,375	67,370
Capital reserve	464	464	464
Retained loss	(54,565)	(33,162)	(47,628)
Total equity attributable to equity shareholders of the company	**25,731**	**28,094**	**23,727**

Statement of cash flows	**As at**	***Restated **** **As at**	**12 Months to 31 December**
	30-Jun-24	**30-Jun-23**	**2023**
	Unaudited	**Unaudited**	**Audited**
	£'000	**£'000**	**£'000**
Cash flow from operating activities			
Loss after tax for the year	(7,054)	(4,999)	(19,559)
Adjusted for:			
Depreciation and amortisation charge	708	591	1,262
Disposal of fixed assets	-	-	6
Impairment of assets	-	-	9,238
Non-government grant amortisation	(7)	-	(13)
Equity settled share-based payment expenses	117	108	201
Foreign exchange (gains)/losses	6	43	54
Financial expense	257	87	176
Financial income	(57)	(2)	(5)
Taxation	(539)	(643)	(1,163)
	(6,569)	(4,815)	(9,803)
Changes in working capital			
Increase in inventories	(887)	(647)	(1,093)
Increase in trade and other receivables	(1,607)	(2,118)	(537)
Increase in contract fulfillment assets	(366)	(44)	(649)
(Decrease)/Increase in trade and other payables	(41)	(179)	649
	(9,469)	(7,804)	(11,433)
Taxation received	-	1,172	1,172
Net cash used in operating activities	**(9,469)**	**(6,632)**	**(10,261)**
Cash flows from investing activities			
Acquisition of tangible assets	(3,432)	(1,566)	(4,769)
Acquisition of intangible assets	(24)	(3,273)	(3,279)
Interest received	57	2	5
Net cash used in investing activities	**(3,399)**	**(4,837)**	**(8,043)**
Cash flows from financing activities			
Proceeds from issue of share capital	9,500	171	11,195
Costs for issue of share capital	(560)	-	(925)
Payment of finance lease liabilities	(251)	(85)	(356)
Proceeds from Borrowings	[illegible]		

Proceeds from Borrowings	3,593	-	-
Payments of interest bearing borrowings	(91)	(191)	(240)
Interest paid	(200)	(87)	(176)
Net cash generated from financing activities	**11,793**	**(192)**	**9,498**
Net (decrease)/increase in cash and cash equivalents	**(1,075)**	**(11,661)**	**(8,806)**
Foreign exchange losses	(6)	(42)	(54)
Cash and cash equivalents at the beginning of the period	6,064	14,924	14,924
Cash and cash equivalents at the end of the period	**4,983**	**3,221**	**6,064**

Statement of Changes in Equity for the six months ended 30 June 2023	**Share capital**	**Share premium account**	**Capital reserve**	**Retained Loss**	**Total**
	£'000	£'000	£'000	£'000	£'000
Balance as at 31 December 2023	3,521	67,370	464	(47,628)	23,727
Comprehensive income for the year					
Loss for the period	-	-	-	(7,054)	(7,054)
Total comprehensive income for the year	-	-	-	(7,054)	(7,054)
Transactions with owners, recorded directly to equity					
Shares issued in the period	9,500				9,500
Share options exercised					-
Cost of issue to share premium		(560)			(560)
Equity settled share based payment transactions				117	117
Total contributions by and distributions to the owners	9,500	(560)	-	117	9,057
Balance as at 31 December 2023	13,021	66,810	464	(54,565)	25,731

Notes

1. Accounting policies

The interim financial statements are the responsibility of the Directors and were authorised and approved by the Board of Directors for issuance on 29 September 2024.

Basis of preparation

The Company is a public limited liability Group incorporated and domiciled in England & Wales. The financial information is presented in Pounds Sterling (£) which is also the functional currency. The Company's accounting reference date is 31 December.

These interim results for the period ended 30 June 2024, which are not audited, do not comprise statutory accounts within the meaning of section 435 of the Companies Act 2006. They have not been prepared in accordance with IAS 34, Interim Financial Reporting that is not mandatory for UK AIM listed companies, in the preparation of this half-yearly financial report. While the financial information included has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards (IFRS), as adopted by the UK adopted international accounting standards, these interim results do not contain sufficient information to comply with IFRS.

Full audited accounts of the Company in respect of the year ended 31 December 2023, which received an unqualified audit opinion and did not contain a statement under section 498(2) or (3) (accounting record or returns inadequate, accounts not agreeing with records and returns or failure to obtain necessary information and explanations) of the Companies Act 2006 and have been delivered to the Registrar of Companies.

The accounting policies used in the preparation of the financial information for the six months ended 30 June 2024 are in accordance with the recognition and measurement criteria of IFRS as adopted by the UK adopted international accounting standards and are consistent with those which will be adopted in the annual statutory financial statements for the year ending 31 December 2024.

Prior Year Restatement - Revenue Recognition for System Integration Services (IFRS 15):

In the 2023 audited accounts we reassessed our interpretation of revenue recognition for multi-year service integration contracts under IFRS 15. This resulted in changes to the criteria upon which revenue is recognised for certain engineering, testing, and tooling services. Previously, revenue had been recognised by a careful assessment of these services over time based on the stage of completion for each contract, using detailed project information. This approach which aimed to reflect a fair representation of revenue earned, aligned with management's previous interpretation of IFRS 15. The Company has been unable to adequately evidence the right to payment for incomplete performance obligations. The new interpretation is to recognise revenue at a point in time being either upon completion of system integration by the OEM or when control is passed over for the contracted services.

Based on this new interpretation management determined there to be a material difference in how the Company has previously recognised revenue. To comply with IAS 8 the company retrospectively applied this new interpretation, and the Company has adjusted prior year audited financial statements and reflected this adjustment at the H1-2023 period to show a like for like comparison. This revised approach reflects a reduction in revenue recognised in the years ended 31 December 2023 and 2022.

These adjustments have also impacted other financial statement line items, such as cost of sales, contract receivables and contract fulfillment assets. The Company now expects to recognise more revenue for these services in future periods as system integrations are completed by the OEM's.

Critical accounting estimates and judgements

The preparation of financial statements in conformity with adopted IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Key estimates assessed by management are as follows:

liabilities, income and expenses. Key estimates assessed by management are as follows:

Deferred tax

Management estimation is required to determine the amount of deferred tax assets recognised. This requires considering the likelihood and timing of future taxable profits, along with potential tax planning strategies. Currently, management hasn't recognised deferred tax assets exceeding the recognised deferred tax liability.

Key judgements assessed by management are as follows:

Research and development expenditure

The Board considers the definitions of research and development costs as outlined in IAS 38: Intangible Assets when determining the correct treatment of costs incurred. Where such expenditure is technically and commercially feasible, the Company intends and has the technical ability and sufficient resources to complete development, future economic benefits are probable and if the Company can measure reliably the expenditure attributable to the intangible asset it is treated as development expenditure and capitalised on the statement of financial position.

The Company has determined that it will not capitalise intangible assets at the half-year end and this decision is based on an ongoing assessment of the criteria. A comprehensive review will be conducted to determine whether the criteria for capitalisation have been met by the year-end. The decision at the half-year end does not affect the Company's overall financial position or operations. The Company remains committed to maintaining accurate and transparent financial reporting.

Revenue Recognition for the provision of brake discs

For core manufacturing activities, where the primary activity is the sale of manufactured carbon ceramic brake discs, revenue is typically recognised at a point in time when control of the goods has passed to the customer, which usually occurs upon dispatch of the goods. These contracts typically contain only one performance obligation, which is the delivery of the goods. The majority of revenue is currently recognised at a point in time, when the control of the goods has passed to the buyer (usually on dispatch of the goods). These contracts contain only one performance obligation being the provision of the specified goods.

Revenue Recognition for System Integration Services (IFRS 15)

Revenue for contracted services, including engineering, testing, and tooling services provided during system integration projects, is recognised at a point in time when the performance obligation is deemed satisfied.

The performance obligation for these contracted services is considered satisfied when the system integration by the OEM is complete, or when control is passed over for the contracted services. There has been no recognition of revenue for system integration services in the period.

Inventories

Inventories are stated at the lower of cost and net realisable value. In determining the cost of raw materials and consumables the purchase price is used. For work in progress and finished goods, cost is taken as production cost.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Depreciation is charged to the statement of total comprehensive income on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives are as follows:

- Plant and machinery 15 - 5 years
- Fixtures and fittings 3 years
- Leasehold improvements Over life of lease
- Buildings (right of use) Over life of lease
- Land n/a

Depreciation methods and useful lives are reviewed at each balance sheet date. No depreciation is charged on assets classified as capital in progress. Depreciation is charged once an asset in brought into use by the business. Land is held at cost, subject to impairment charges.

2. Taxation

Analysis of credit in period

	Six months ended 30-Jun 2024 £'000 (unaudited)	Six months ended 30-Jun 2023 £'000 (unaudited)	Twelve Months ended 31-Dec 2023 £'000 (audited)
UK Corporation tax			
Adjustment in respect of prior years R&D tax allowance	(206)	33	33
R&D tax allowance for current period	(333)	(676)	(1,196)
	(539)	(643)	(1,163)

The effective rate of tax for the period/year is lower than the standard rate of corporation tax in the UK of 25%, principally due to losses incurred by the Company.

The potential deferred tax asset relating to losses has not been recognised in the financial statements because it is not possible to assess whether there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

3. Loss per share

Basic	Six months ended to 30-Jun-2024	Six months ended to 30-Jun-2023	Twelve months ended 31- Dec-2023
Loss after tax (£)	(7,054,000)	(4,999,000)	(19,559,000)
Weighted average number of shares (No. of shares)	551,357,372	240,979,421	204,340,456
Loss per share (pence)	(1.28p)	(2.07p)	(9.57p)

Loss per ordinary share is based on the Company's loss for the financial period of £7,054k (30 June 2023: £4,999k loss; 31 December 2023: £19,599k loss). The weighted average number of shares used in the basic calculation is 551,357,372 (30 June 2023: 240,979,421; 31 December 2023: 247,044,609).

The calculation of diluted loss per ordinary share is identical to that used for the basic loss per ordinary share. This is because the exercise of share options would have the effect of reducing the loss per ordinary share and is therefore not dilutive under the terms of International Accounting Standard 33 "Earnings per share".

END

IR SELFAUELSEDU