RNS Number : 8351C
Science Group PLC
31 March 2025

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Science Group plc

(the "Group" or "Science Group")

Update on Ricardo plc

Science Group shareholding in Ricardo plc ("Ricardo") is 10,483,684 shares, equivalent to approximately 16.85% of the voting rights. The average cost (including brokerage fees) is 232 pence per share. Science Group may or may not increase its shareholding in Ricardo.

Science Group and Ricardo provide similar consultancy services and engineering systems. Science Group issued its Annual Results for the year ended 31 December 2024 on 24 March 2025. In stark contrast to the Ricardo Interim Results (released on 5 March 2025), Science Group reported robust operating margins, record earnings per share and strong cash conversion, despite the same challenging "*market headwinds*" that Ricardo blamed for its weak performance, poor cash flow and materially downgraded forecasts. Science Group actually delivers the margins that Ricardo aspires to.

Science Group set out its concerns to the Ricardo Board in the announcements of 14 and 17 March 2025 and in a 90 minute meeting with the Senior Independent Director and an advisor. In RNS responses, Ricardo has consistently ignored the serious matters raised and instead has sought to criticise Science Group for acquiring shares in the open market at levels around the Ricardo 15 year low. The irony of the Ricardo Board comments is readily apparent and the responsibility for the destruction of shareholder value (65% peak to trough share price reduction) lies squarely with the Ricardo Board.

Science Group notes Ricardo's announcement on 28 March 2025, which continues to try to deflect attention from the core issues. Contrary to the 'victim' narrative presented by the Ricardo Board, the strategy and financial targets were defined by Ricardo in 2022 and were reiterated by the Ricardo Board as recently as September 2024. The Ricardo Board seeks to blame external factors for its under-performance rather than address its own mismanagement. Furthermore, the statement that Ricardo "*continues to trade in line with the Board's expectations*" conveniently omits the fact that these expectations were significantly downgraded only a few weeks ago. (The 20% downgrade for the current year (continuing businesses) was extraordinary after the strong assurances in September 2024 and just 3 weeks after the highest valued acquisition in Ricardo history, but the future outlook was even worse with house broker analyst forecast downgraded by 31% in FY2026/27.)

Furthermore, the rhetoric that potentially replacing the current Chairman of Ricardo and appointing a single director nominated by Science Group to the Ricardo Board "*would give Science Group effective control of the Board without paying a premium*" is blatantly absurd. This repeated claim by the Ricardo Board is also selective and hypocritical since a current Ricardo director is in fact a nominee of a major shareholder yet there has been no similar accusation. Therefore, and consistent with the lack of substantive responses to Science Group analysis, it must be presumed that the real concern of the Ricardo Board is the scrutiny and governance improvements that Science Group would demand, to the benefit of all Ricardo shareholders.

To reiterate Science Group concerns :

- **Failure to deliver the profitability targets set out in the 2022 strategic plan**. As recently as 11 September 2024, the Ricardo Board reconfirmed that the company was "*On track to double underlying operating profit in the five years to 2026/27*". Unfortunately, not only was that an inaccurate declaration, but when it became apparent that failure was probable and the aspiration challenging, rather than taking the necessary remedial action, the Ricardo Board abolished/diluted the targets.

Among the various Ricardo excuses, the Ricardo Board highlights short-term "*market headwinds*" for their failure, despite one independent analyst in September 2024 describing the Ricardo plan as requiring a "*Goldilocks period*" to meet the forecasts. Similar analysis led Science Group to anticipate the Ricardo January profit warning. However, Science Group has experienced similar market conditions to Ricardo yet still delivered record profitability in FY24, through effective governance and disciplined cost and operational management.

The Ricardo announcement on 28 March 2025 highlights the reported margins on Energy & Environment and Rail, but ignores the fact that the margins are inflated by the non-allocation of some shared services costs (which it is understood account for around half of the reported PLC costs). Ironically, the very high PLC costs are justified by Ricardo using the converse argument, so it is disingenuous for Ricardo to exclude them from segment commentary. The impact of allocating these costs would be a material reduction in the reported segment margins referenced in the 28 March RNS, a reporting change that should be done to improve transparency of Ricardo segment profitability.

(Science Group, by contrast, allocates all shared services costs into the business units. Therefore the segmental margins achieved by Science Group have an even wider deviation from the reported Ricardo segment margins. This delta is further compounded by the diversity of "*specific adjusting items*" excluded by Ricardo in its Underlying Operating Profit definition, which further inflates Ricardo reported margins. While "adjusting items" can be difficult for shareholders to analyse, compare and interpret, cash balances (ie real cash generated by a business) are far less subject to accounting adjustments/interpretations. The Ricardo poor cash conversion is a further cause for concern - see below.)

- **Inadequate financial processes/forecasting/controls**. Just a few months prior to the January profit warning, on 11 September 2024, the Ricardo Board asserted unequivocally that the "*Robust year end order book and good pipeline visibility gives confidence for FY 2024/25*". Furthermore, the house broker noted as recently as December 2024, that "*We believe that the ongoing business continues to trade well*", presumably reflecting dialogue with the company.

  Either Ricardo financial processes and controls are inadequate or there must be questions of competency. In either case, the company clearly does not have the governance to pursue acquisitions, and certainly not on the other side of the world (3 of the last 4 acquisitions have been undertaken in Australia). Science Group believes that Ricardo needs to establish solid foundations before layering on risk and complexity. Growth via acquisition is not a substitute for disciplined operational and cost management.

  Science Group has informed the Ricardo Board that it will not support any further Ricardo acquisitions until a consistency of performance has been demonstrated. In view of the January events, any acquisitions or disposals should be subject to shareholder approval.

- **Poor cost control and productivity.** While "*market headwinds*" can be outside a company's control, the very high corporate costs at Ricardo are not, yet are wholly disproportionate to the market capitalisation of the company.

  Similarly the Ricardo poor productivity should have been addressed by the Ricardo Board. Ricardo revenue per head (c.£130,000 based on FY 2023/24, excluding Defense) is materially lower than Science Group. Indeed, the difference in productivity alone can reconcile the margin difference between Science Group and Ricardo, and explain the failure of Ricardo to hit its 2022 margin targets. To be clear, if Ricardo had achieved the same productivity as Science Group (c.£163,000 in FY23 and higher in FY24), the Ricardo 2022 margin targets would have been achieved or exceeded. (Science Group has consistently delivered margins above the Ricardo aspirational targets).

  Therefore, while "*market headwinds*" have impacted all consultancies and have contributed to the poor Ricardo performance, the failure of the Ricardo Board to achieve its own targets is primarily a failure to manage costs and productivity. These are issues within the control of the Ricardo Board.

- **Poor cash conversion.** As noted above, in H1-FY25, Ricardo reported cash conversion of just 13% from continuing operations and a negative -5.8% for the whole business, a serious concern but unfortunately a recurring Ricardo under-performance for this critical business metric. This further implies that the September 2024, much-acclaimed at the time, "*excellent cash performance*" was in fact an unsustainable 'window dressing', immediately unravelling in the following reporting period.

  Science Group regards cash generation to be the primary metric of any business and, while short term fluctuations do occur, actual cash generated provides a reliable performance metric. Ricardo accounting adjustments (referenced above) are exposed in the reality of consistently poor cash generation. In contrast Science Group cash conversion consistently correlates with reported adjusted operating profit.

- **Excessive executive remuneration** has been highlighted by other Ricardo shareholders in the past, when the market valuation was much higher, although the response of the Ricardo Board was similarly dismissive. For a company of Ricardo's current market capitalisation, the level of executive remuneration is indefensible. Self-interest appears to take precedence over shareholder value.

  For comparison, Ricardo FY2023/24 Board remuneration totalled £2.1 million (excluding former CFO compensation) yet the aggregate shareholding of the Board is just 0.2%. In contrast, Science Group total Board remuneration was around 40% lower at £1.2 million and the Board shareholdings total 21.5%. Science Group market capitalisation is greater than Ricardo and the Board alignment with shareholders is evidenced by the consistent index-beating returns, contrasting sharply with the Ricardo Board destruction of shareholder value.

- **Ineffective governance.** It is seriously concerning that, rather than stabilise the business with the Defense disposal cash inflow, the Ricardo Board immediately deployed the precious capital to the highest value acquisition in Ricardo's history (located in Australia). To complete such a high risk transaction just 3 weeks before issuing a major profit warning is a serious and irresponsible failure of governance. As a result, Ricardo now has an over-stretched balance sheet and poor cash flow, requiring the recent amendment of bank covenants.

  All of the above items individually and collectively provide a damning critique of the Ricardo Board. Yet, despite the serious failings in governance, the Ricardo Board have not accepted any responsibility and indeed have proclaimed unanimity (14 March 2025 and 28 March 2025) of mutual support. Such lack of accountability does not provide reassurance to shareholders and indeed raises even more concerns regarding the lack of Board independence, scrutiny and governance.

Ricardo Business and Strategy Update

Despite three RNS announcements by Ricardo in recent weeks, the above matters, which are fundamental to shareholder value recovery, remain unaddressed. It is at least rewarding to see that Science Group's initiative has finally kick-started the Ricardo Board and we note the announcement that the Business and Strategy Update ("BSU") will be set out in mid-April. However, it should be noted that this will be the fifth corporate/strategic event in five months :

- December : Disposal and acquisition announced.
- January : Completion of acquisition, followed by profit warning 3 weeks later.
- March : Interim Results (including abolition/dilution of strategic margin targets).
- April : Business and Strategy Update (just one month after the Interim Results).

Unfortunately, the ability to issue another new strategic plan (or BSU) is a long way from being able to execute the plan to deliver value to shareholders, as the Ricardo Board have demonstrated over the past 3 years. It is only six months (11 September 2024) since the Ricardo Board declared that "*Ricardo is gaining good momentum to deliver its five-year strategic plan communicated in May 2022*", a claimed "*momentum*" that fizzled out in just a few months. Accordingly, the Ricardo Board's expressed "*strong confidence*" in its imminent new plan/strategy lacks credibility.

The Ricardo Board needs to be held to account and the Chair has ultimate responsibility. The destruction of shareholder value cannot continue and a timely resolution is required to prevent further damage to this once shareholder value cannot continue and a timely resolution is required to prevent further damage to this once great British company and to provide clarity and support for the Ricardo operating managers to be able to focus on operational execution (profit and cash flow) in order to start the business turnaround. Science Group will provide the Ricardo Board the opportunity to present its (5th in 5 months) corporate update by mid April as they have declared (i.e **15 April 2025)** but, as advised in the meeting with the Ricardo Senior Independent Director, we seek assurance that no disposals or acquisitions will be undertaken without shareholder approval.

In that regard, Science Group notes analyst commentary regarding the disposal process related to the Performance Products division, presumably briefed by the company, and considers that the Ricardo Board should immediately correct any selective disclosure and provide transparency to all Ricardo shareholders and other stakeholders.

Ricardo Share Register

As previously referenced, it is significant that the Ricardo shareholder base has materially changed since the January profit warning. Four shareholders now account for approaching 60% of the issued share capital of Ricardo and a further 10% is held by a further handful of holders. Director shareholdings remain very low at around 0.2% and a number of institutional shareholders have 'voted with their feet', selling Ricardo shares after losing confidence in the current Ricardo Board. Ignoring the potential impact from the lack of share trading liquidity, strategically such a shareholder concentration can be a positive if the major holders are aligned, but it could be challenging if there is divergence.

Conclusion

The benefits to all Ricardo shareholders of Science Group's engagement have been demonstrated over the past few weeks, through both the partial Ricardo share price recovery and the increased scrutiny of the Ricardo Board performance that Science Group has stimulated. Unfortunately the Ricardo Board remain in denial and seek to blame external factors rather than accept responsibility.

Science Group considers it inconceivable that, after (1) such poor operating performance, (2) lack of remedial action, (3) ineffective governance and (4) substantial destruction of shareholder value, that the Ricardo Board can unanimously self-certify its fitness to continue to run the company without constraint. It is clear that Ricardo plc needs a catalyst for change and the position of the Chair is untenable.

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