



Surgical Innovations Group plc
Interim report 2011

SHARE OUR TECHNOLOGY... ...SHARE OUR PASSION



Surgical Innovations Group plc specialises in the design and manufacture of innovative devices for use in minimally invasive surgery (MIS) and industrial markets.

Specialising in the design and manufacture of creative solutions for MIS and industrial markets, our pioneering products are user orientated with ergonomics at the core of our technology.

Our growth strategy:

- ▶ Continuous innovation and product development
- ▶ Technology transfer into other areas of MIS
- ▶ Development of both new and existing OEM relationships
- ▶ Continued expansion through organic growth of SI brand in international markets
- ▶ Explore acquisition opportunities in new therapeutic markets



Review of the period

At a glance: Highlights

Financial highlights

- ▶ Revenues of £3.20 million (H1 2010: £3.57 million)
- ▶ Operating profit of £514,000 (H1 2010: £781,000)
- ▶ Pre-tax profit of £474,000 (H1 2010: £766,000)
- ▶ £1.36 million invested in manufacturing, research and development during the period
- ▶ Gross margins in core MIS business increased to 42% (H1 2010: 35%)
- ▶ Net cash of £594,000 generated from operating activities
- ▶ Basic earnings per share of 0.12p (H1 2010: 0.18p)

Operational highlights

- ▶ Current trading is encouraging with strong customer demand across the business
- ▶ SI branded products up 29% to £2.05 million (H1 2010: £1.59 million)
- ▶ Strong demand from OEM partners for R&D expertise
- ▶ Increased penetration of Resposable® products will result in increased demand for high margin disposable parts going forward
- ▶ Development of 3mm instrument range and devices for hip arthroscopy underway
- ▶ Two major new product launches to take place in second half of the year: PretzelFlex™ and Optical Trocar for YelloPort+plus®

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Chairman's statement

“The Group maintained its strategy for growth through continued investment in “added-value” in-house manufacture underpinned by innovative product development.”

Doug Liversidge CBE
Chairman



Summary of Chairman's statement

- Gross margins in core MIS business increased to 42% (H1 2010: 35%)
- Sales of SI branded products increased 29% to £2.05 million (H1 2010: £1.59 million)
- The Board remains very confident about expected growth in 2012 and 2013

I am pleased to report that good progress has been made in the first half of the year, particularly the underlying core business where customer demand has been strong. The revenues at the half year were lower on a like-for-like basis primarily because of the lack of repeat orders from the industrial business, which had a significant one off impact on the prior period in 2010, as well as a smaller temporary reduction in OEM revenues, due to the phasing of larger orders.

Pre-tax profit was £474,000 (H1 2010: £766,000) on revenues of £3.20 million (H1 2010: £3.57 million). Gross margins rose in the core business to 42% (H1 2010: 35%) as a result of increased revenues from higher margin SI branded products.

Sales of SI branded products increased 29% to £2.05 million (H1 2010: £1.59 million). New markets were established during the period in Australasia and Saudi Arabia, as well as the engagement of a new distributor in South Africa. Surgical Innovations also became, from July 2011, the sole supplier of Resposable® laparoscopic ports to Life Group, one of South Africa's largest health insurers.

The presence of the SI Brand in the US has continued to grow both with the Group's flagship Resposable® product YelloPort+plus® as well as the Logi®Range

and LogiCut® product ranges.

As previously described, our strategy for the sales of YelloPort+plus® in the US benefits from being distributed via serviced tray companies and, to this end, we signed a four-year contract for its inclusion in Mediflex's Laparo-Logix™ procedure pack in February 2011.

Furthermore a five-year extension to the distributor agreement was recently signed with SI US Inc., the Group's exclusive US master distributor. Under this agreement SI US will distribute the Logi®Range and LogiCut® product range together with the reusable line and has been granted first refusal to all future SI branded products over the next five years.

Revenues for the OEM business were lower at £1.15 million (H1 2010: £1.34 million). This was the result of a temporary reduction in revenues from a large OEM customer, which was largely offset by revenues from other new OEM customers.

In addition I am delighted to report positive clinical feedback and progress for another key OEM partner, following the launch of their instrument range in the first half of 2011. We anticipate increased revenues throughout the lifecycle of this product range and significant investment has been made in the manufacturing area to ensure our ability to deal with anticipated demand.

The recent announcement of an agreement with CareFusion for the Group's second generation retractor, PretzelFlex™, is a real milestone for SI. PretzelFlex™ is an innovative advanced version of SI's "gold standard" reusable retractor EndoFlex® which is widely used by surgeons to reposition large organs such as the liver to gain access to other organs during surgery. The predetermined shape of the product gives it much greater strength than its predecessor. This has become necessary as livers in particular have become larger as a result of the increasing obesity problem. With

over 250,000 procedures taking place in the US alone that require an effective retractor we are anticipating that PretzelFlex™ will become the device of choice for many laparoscopic surgeons in the future. Its comparative greater strength to its predecessor is also allowing us to develop both Resposable® and 3mm versions of the instrument.

Utilising the strength of our product development team within the MIS environment we have been able to attract interest from several major OEM organisations. Earlier this month we entered into an agreement with Advanced Medical Solutions Group plc (AMS) to develop a laparoscopic applicator to deliver accurately individual drops of adhesive or sealant internally within the body. We believe that together we will have an advantage in the deployment of glues for use within the laparoscopic field, which is currently served by sutures, staples and tacks. With the launch of the product expected in 2013, SI will manufacture the delivery device and own the intellectual property in return for granting AMS worldwide exclusive rights to the device for a period of ten years.

Investment in manufacturing, research and development has remained strong with £1.36 million invested during the period. The Group continues to develop a number of new products and improvements to existing products. There have been concerted efforts in developing a 3mm instrument range which has received excellent clinical feedback and we are currently in the latter stages of the development of a new Optical Trocar for YelloPort+plus® which is due for launch in November this year.

Following the appointment of arthroscopy specialist J Conroy to the Clinical Advisory Board in January this year, we are currently working on adapting our port and flex technology to this rapidly growing market.

Revenue from the industrial business has returned to historic levels as expected. We continue to engage with industrial partners to explore opportunities where our intellectual property can be adapted to industrial applications. However, it is difficult to predict the timing and value of these projects at present.

Outlook

With the extensive work being carried out in the US, anticipated product launches, existing sales commitments from our OEM customers and distributors, and increased penetration of our products, we remain very confident about our expected growth into 2012 and 2013. Current trading is encouraging with strong customer demand in SI branded products and a significant improvement in OEM sales.

I would like to thank our staff for all their hard work and commitment, and look forward to updating shareholders on our progress over the next few months.

Doug Liversidge CBE

Chairman

14 September 2011

Unaudited consolidated statement of comprehensive income

for the six months ended 30 June 2011

	Notes	Unaudited six months ended 30 June 2011 £'000	Unaudited six months ended 30 June 2010 £'000	Audited year ended 31 December 2010 £'000
Revenue	2	3,196	3,567	7,045
Cost of sales		(1,857)	(2,244)	(3,526)
Gross profit		1,339	1,323	3,519
Other operating expenses		(824)	(537)	(1,932)
Share-based payments		(1)	(5)	(8)
Operating profit		514	781	1,579
Finance costs		(47)	(21)	(39)
Finance income		7	6	9
Profit before taxation		474	766	1,549
Taxation	3	—	(89)	239
Profit and total comprehensive income for the period attributable to the owners of the parent		474	677	1,788
Earnings per share				
Basic	4	0.12p	0.18p	0.48p
Diluted	4	0.12p	0.17p	0.45p

Unaudited consolidated interim balance sheet

as at 30 June 2011

	Unaudited 30 June 2011 £'000	Unaudited 30 June 2010 £'000	Audited 31 December 2010 £'000
Assets			
Non-current assets			
Property, plant and equipment	2,511	2,356	2,477
Other intangible assets	4,053	2,535	3,295
Deferred tax asset	432	104	432
	6,996	4,995	6,204
Current assets			
Inventories	2,461	1,836	2,033
Trade receivables	1,985	2,286	2,168
Other current assets	849	661	513
Cash and cash equivalents	2,892	2,354	2,622
	8,187	7,137	7,336
Total assets	15,183	12,132	13,540
Equity and liabilities			
Equity attributable to equity holders of the parent company			
Share capital	3,947	3,738	3,815
Share premium account	215	18,809	75
Capital reserve	329	329	329
Retained earnings	6,844	(13,554)	6,369
Total equity	11,335	9,322	10,588
Non-current liabilities			
Obligations under finance leases and hp loans	625	688	653
	625	688	653
Current liabilities			
Bank overdraft	1,757	1,104	1,177
Trade and other payables	829	512	607
Obligations under finance leases and hp loans	358	278	350
Accruals	279	228	165
	3,223	2,122	2,299
Total liabilities	3,848	2,810	2,952
Total equity and liabilities	15,183	12,132	13,540

Unaudited consolidated interim cash flow statement

for the six months ended 30 June 2011

	Unaudited six months ended 30 June 2011 £'000	Unaudited six months ended 30 June 2010 £'000	Audited year ended 31 December 2010 £'000
Cash flows from operating activities			
Operating profit	514	781	1,579
Adjustments for:			
Depreciation of property, plant and equipment	239	183	448
Amortisation of intangible assets	132	332	518
Share-based payment	1	5	8
Operating cash flows before movement in working capital	886	1,301	2,553
(Increase)/decrease in inventories	(428)	211	14
Increase in receivables	(153)	(352)	(86)
Increase/(decrease) in trade and other payables	336	(272)	(240)
Cash generated from operations	641	888	2,241
Interest paid	(47)	(21)	(39)
Net cash generated from operating activities	594	867	2,202
Cash flows from investing activities			
Interest received	7	6	9
Acquisition of non-current assets	(1,034)	(854)	(2,044)
Net cash used in investing activities	(1,027)	(848)	(2,035)
Cash flows from financing activities			
Cash received from issue of shares	272	—	152
Repayment of obligations under finance leases and hp loans	(149)	(154)	(259)
Net cash generated from/(used in) financing activities	123	(154)	(107)
Net (decrease)/increase in cash and cash equivalents	(310)	(135)	60
Cash and cash equivalents at beginning of period	1,445	1,385	1,385
Cash and cash equivalents at end of period	1,135	1,250	1,445
Cash at bank and in hand	2,892	2,354	2,622
Bank overdraft	(1,757)	(1,104)	(1,177)
Cash and cash equivalents at end of period	1,135	1,250	1,445

Unaudited consolidated interim statement of changes in equity

for the six months ended 30 June 2011

	Share capital £'000	Share premium £'000	Capital reserve £'000	Retained earnings £'000	Total £'000
Balance as at 1 January 2011	3,815	75	329	6,369	10,588
Employee share-based payment options	—	—	—	1	1
Transaction with owners	132	140	—	—	272
Profit and total comprehensive income for the period	—	—	—	474	474
Unaudited balance as at 30 June 2011	3,947	215	329	6,844	11,335

Notes to the financial statements

1. Basis of preparation of interim financial information

The interim financial information was approved by the Board of Directors on 14 September 2011. The financial information set out in the interim report is unaudited.

The interim financial statements have 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 2010, 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.

The financial information set out in this interim report does not constitute statutory accounts as defined in Section 434 of the Companies Act 2006. The figures for the year ended 31 December 2010 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

For management purposes the Group is organised into three business segments: SI Brand, OEM and Industrial. These revenue streams are the basis on which the Group reports its segment information.

Segment results, assets and liabilities include assets directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate assets and liabilities and head office expenses.

These operating segments are monitored and strategic decisions are made on the basis of adjusted segment operating results.

Business segments

The principal activities of the SI Brand business unit are the research, development, manufacture and distribution of SI branded minimally invasive devices.

The principal activities of the OEM business unit is the research, development, manufacture and distribution of minimally invasive devices for third party medical device companies through either own label or co-branding.

The principal activities of the industrial business unit is the research, development, manufacture and sale of minimally invasive technology products for industrial application.

The following segmental analysis has been produced to provide a reconciliation between the information used by the key decision maker within the business and the information as it is presented under International Financial Reporting Standards.

Six months ended 30 June 2011 (unaudited)	SI Brand £'000	OEM £'000	Industrial £'000	Total £'000
Revenue	2,046	1,150	—	3,196
Result				
Segment result	789	354	—	1,143
Unallocated expenses	—	—	—	(629)
Profit from operations	—	—	—	514
Finance income	—	—	—	7
Finance costs	—	—	—	(47)
Profit before taxation	—	—	—	474
Tax	—	—	—	—
Profit for the period	—	—	—	474

2. Segmental reporting continued**Business segments** continued

Six months ended 30 June 2010 (unaudited)	SI Brand £'000	OEM £'000	Industrial £'000	Total £'000
Revenue	1,589	1,341	637	3,567
Result				
Segment result	416	390	289	1,095
Unallocated expenses	—	—	—	(314)
Profit from operations	—	—	—	781
Finance income	—	—	—	6
Finance costs	—	—	—	(21)
Profit before taxation	—	—	—	766
Tax	—	—	—	(89)
Profit for the period	—	—	—	677
Year ended 31 December 2010 (audited)	SI Brand £'000	OEM £'000	Industrial £'000	Total £'000
Revenue	3,852	2,506	687	7,045
Result				
Segment result	1,151	930	390	2,471
Unallocated expenses	—	—	—	(892)
Profit from operations	—	—	—	1,579
Finance income	—	—	—	9
Finance costs	—	—	—	(39)
Profit before taxation	—	—	—	1,549
Tax	—	—	—	239
Profit for the year	—	—	—	1,788

The reportable segment assets and liabilities at 30 June 2011 are as follows:

	SI Brand £'000	OEM £'000	Industrial £'000	Unallocated £'000	Total £'000
Assets	8,201	2,291	33	4,658	15,183
Liabilities	—	—	—	15,183	15,183
				Assets £'000	Liabilities £'000
Segment assets/liabilities				10,525	—
Unallocated:					
Property, plant and equipment				568	—
Other debtors				766	—
Cash and cash equivalents				2,892	—
Deferred tax asset				432	—
Borrowings				—	2,740
Trade and other payables				—	829
Accruals				—	279
Equity				—	11,335
				15,183	15,183

Notes to the financial statements continued

2. Segmental reporting continued

Business segments continued

The reportable segment assets and liabilities at 30 June 2010 are as follows:

	SI Brand £'000	OEM £'000	Industrial £'000	Unallocated £'000	Total £'000
Assets	6,337	1,392	683	3,720	12,132
Liabilities	—	—	—	12,132	12,132
				Assets £'000	Liabilities £'000
Segment assets/liabilities				8,412	—
Unallocated:					
Property, plant and equipment				649	—
Other debtors				613	—
Cash and cash equivalents				2,354	—
Deferred tax asset				104	—
Borrowings				—	2,070
Trade and other payables				—	512
Accruals				—	228
Equity				—	9,322
				12,132	12,132

The reportable segment assets and liabilities at 31 December 2010 are as follows:

	SI Brand £'000	OEM £'000	Industrial £'000	Unallocated £'000	Total £'000
Assets	7,317	2,122	55	4,046	13,540
Liabilities	—	—	—	13,540	13,540
				Assets £'000	Liabilities £'000
Segment assets/liabilities				9,494	—
Unallocated:					
Property, plant and equipment				477	—
Prepayments and accrued income				232	—
Other debtors				283	—
Cash and cash equivalents				2,622	—
Deferred tax asset				432	—
Borrowings				—	2,180
Trade and other payables				—	607
Accruals				—	165
Equity				—	10,588
				13,540	13,540

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories and trade and other receivables. Assets are not allocated to a segment primarily consisting of tangible fixed assets, prepayments and accrued income and cash and cash equivalents.

Liabilities are not capable of allocation to individual segments.

2. Segmental reporting continued

Geographical analysis

	Unaudited six months ended 30 June 2011 £'000	Unaudited six months ended 30 June 2010 £'000	Audited year ended 31 December 2010 £'000
United Kingdom	498	1,949	2,119
Europe	1,505	807	2,908
US	866	637	1,410
Rest of World	327	174	608
	3,196	3,567	7,045

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

3. Taxation

The charge for current tax is based on the results for the period as adjusted for items which are non-assessable or disallowed and any adjustment to tax payable in respect of previous years. It is calculated using the estimated effective rate for the period, based on the mainstream rate of 27% and on a basis consistent with that to be used in the full year.

4. Earnings per share

	Unaudited six months ended 30 June 2011	Unaudited six months ended 30 June 2010	Audited year ended 31 December 2010
Earnings per share			
Basic	0.12p	0.18p	0.48p
Diluted	0.12p	0.17p	0.45p

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

The Group has one category of dilutive potential ordinary shares: those share options granted where the exercise price is less than the average price of the Company's ordinary shares during the period.

	Unaudited six months ended 30 June 2011	Unaudited six months ended 30 June 2010	Audited year ended 31 December 2010
Weighted average number of ordinary shares as at 30 June 2011 (undiluted)	390,115,571	373,841,902	375,812,587
Dilutive effect of share options in issue	9,176,016	20,328,780	21,527,323
Weighted average number of ordinary shares as at 30 June 2011 (diluted)	399,291,587	394,170,682	397,339,910

Earnings attributable to ordinary shareholders used in the calculation of basic and diluted earnings per share is as follows:

	Unaudited six months ended 30 June 2011 £'000	Unaudited six months ended 30 June 2010 £'000	Audited year ended 31 December 2010 £'000
Profit for the period	474	677	1,788

Advisers

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Glossary of terms

Laparoscopic

Refers to minimally invasive surgery carried out in the abdominal cavity.

Minimally Invasive Surgery (MIS)

Surgery carried out through small incisions (keyholes), thereby minimising wound trauma.

Original Equipment Manufacture (OEM)

Manufacture of products supplied to other companies, for sale by those companies under their own brand.

Port access system

Devices used for gaining access to the abdominal cavity through small incisions.

Responsible®

A device or range comprising reusable main elements and disposable accessories.

Shareholder information

Warning to shareholders – boiler room scams

Over the last year, many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based “brokers” who target UK shareholders, offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. These operations are commonly known as “boiler rooms”. These “brokers” can be very persistent and extremely persuasive and a 2006 survey by the Financial Services Authority (FSA) has reported that the average amount lost by investors is around £20,000.

It is not just the novice investor that has been duped in this way; many of the victims had been successfully investing for several years. Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports. If you receive any unsolicited investment advice:

- make sure you get the correct name of the person and organisation;
- check that they are properly authorised by the FSA before getting involved by visiting www.fsa.gov.uk/register;
- report the matter to the FSA either by calling 0845 606 1234 or visiting www.moneymadeclear.fsa.gov.uk; and
- if the calls persist, hang up.

If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. The FSA can be contacted by completing an online form at www.fsa.gov.uk/pages/doing/regulated/law/alerts/overseas.shtml.

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

More detailed information on this or similar activity can be found on the FSA website www.moneymadeclear.fsa.gov.uk.



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