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SHG

18% sales growth and
reduced losses

2.63p 06.08.08



Source: www.advfn.com

SHG (Sexual Health Group)'s results reflect the company's strong revenue growth momentum and improving profitability. Sales were up 18% thanks to strong demand, as sexual health and patient hygiene are top priorities of the NHS. Gross operating margin slightly increased, from 44% to 45%, due to a rising proportion of higher-margin new products and own-brand products. Cost control also contributed positively, as administrative costs were flat. Net loss for the year was cut by about a quarter to £0.2m.

SHG is an approved supplier to the NHS in the areas of sexual health, patient hygiene and diagnostic products, with a significant 5% market share of the NHS condom market, representing 1.7% of the total UK market. The company has been very active in developing products in association with the NHS and has been leveraging this collaborative approach to increase its market share and expand its product range. In April 2008, SHG envisaged the acquisition of Pasante, a larger competitor, but the project was eventually withdrawn. SHG then launched a £500,000 share and convertible unsecured loan issue to fund the replacement of loans close to redemption, the costs of the withdrawn Pasante acquisition, and working capital needs aimed at supporting growth – with the recruitment of a new sales person. £305,000 has been raised so far (2/3 in shares, 1/3 in convertible loan notes) and the share issue is still ongoing at 2p.

SHG's future growth should be driven by its strong pipeline of new product development as well as acquisitive growth aimed at helping the company reach critical size, and potential targets have already been identified in this respect. Gross margin should continue to increase, thanks to the wider product offering and increasing own branding. This, combined with sustained cost control, bodes well for SHG's future profitability.

Share Price: 2.63p

12m High: 5.875p

12m Low: 1.63p

Market Cap: £1.25m before share issue

Shares in Issue: 47.7m + 2.13m stock options (strike price: 16p).

EPIC Code: SHGP

Sector: Healthcare

Market: London PLUS

Corporate Advisor: Nexus

PR: Bishopsgate Communications

Website:
www.sexualhealthgroup.com

Previous Research Note:
'Convertible and Share Issue' 2.25p
19.06.08

Analyst: Yvette Riachi

Y/E	Sales £m	Declared Profit £m	Adjusted Profit £m	Adjusted Eps p.	P/e ratio	Divi p.	Yield %
2007A	0.60	-0.23	-0.23	-0.6	-	0	-
2008A	0.70	-0.17	-0.17	-0.5	-	0	-
2009E		No forecast					-
2010 E		No forecast					

Background

SHG- Sexual Health Group Plc - was formed in 2004 by George Sutherland, in consultation with healthcare professionals, to address the need for condoms which would meet strict healthcare requirements and would be distributed through the NHS. The company initially created the Condomania brand as a supplier of condoms to the NHS. It has a 5% market share of the NHS condom market which represents 1.7% of the total UK market. SHG was listed on PLUS in January 2005.

SHG has a portfolio of products in the areas of sexual health and patient hygiene. Its business model is based on consulting with NHS experts to develop products to their own specifications. SHG's status as an approved NHS supplier has been nurtured by its collaborative approach to product supply, as well as various other initiatives. All its products have been researched, developed and created in consultation with health professionals and developed for supply through the NHS. It has been invited by the Department of Health to become a stakeholder in a working party looking at future sexual health strategies. It sponsors the Royal College of Nursing's online learning programme.

In recent years, SHG has widened its product range to include patient hygiene products. In April 2008, the company envisaged acquiring Pasante, a competitor both larger and with a wider retail presence but the external funding needed proved difficult, given current market conditions for financial transactions, and the projected acquisition was withdrawn.

The company carried out a £0.3m share placing in September 2007 at 5p per share. And in June 2008, it launched a £500,000 share and convertible loan issue to fund current needs and support its expansion, of which £305,000 has been raised so far.

SHG is mainly owned by George Sutherland (52% of total equity) and members of his family (20%), which secures alignment of interests and 100 shareholders in total. Investors include one institutional investor, Majedie Investments plc, and individuals.

Client Base

Sales are mainly to the NHS and other clients are mainly wholesale pharmacies.

The NHS's needs and committed budgets

The UK government is committed to healthcare spending and reform, which underpins NHS spending. On 9 October 2007, the Chancellor, Alistair Darling, announced a rise of healthcare spending above inflation of 4% to £90bn in 2007, and to £110bn by 2010. More specifically, sexual health is one of the top priority

concerns of the Department of Health, alongside smoking cessation, obesity and binge drinking, as the UK is suffering an epidemic in sexually-transmitted infections. £130m has been allocated in 2008 to improve sexual health clinic services alone. 180m condoms are sold in the UK each year, of which approximately 60m (one third) are sales to the NHS. The government is also keen to address the problems of healthcare acquired infections (HAI), which cost the NHS £1bn a year, and concerns about 'superbugs' in hospitals raised during the 2005 General Elections remain very topical.

SHG's relationship with the NHS

The company is an NHS approved supplier with a number of contracts already in place. It is present at all levels of the NHS: the Department of Health (i.e. the NHS purchasing nationally), individual NHS Trusts (i.e. regional NHS organisations, each of which has its own policy for condoms supply) and NHS clinics. SHG's collaborative relationship with the NHS means that SHG's products cater to specific needs which facilitates immediate sales for the company. Competition is and should remain limited, as barriers to entry into the NHS market are high and SHG also benefits from first mover advantage. SHG's educational and marketing programs further supports the company's sales by raising awareness of its products.

Production and Business Mix

SHG is classified as a manufacturer for regulatory purposes. All its products meet strict regulatory requirements. In particular, it is compliant with ISO 9001:2000 and ISO 13485:2003 requirements for quality management systems whereby an organisation needs to demonstrate its ability to provide medical devices and related services which consistently meet both customer and regulatory requirements. It has also been granted MHRA approval for medical devices. (The MHRA - Medicines and Healthcare products Regulatory Agency is the government agency responsible for controlling medicines and medical devices for efficacy and safety).

Products are manufactured in the UK and Europe. All providers are 'ISO registered' and every batch of products is quality-checked. SHG also constantly reviews suppliers and has alternative suppliers.

The company has developed 29 different products with NHS England, which represents 90% of the total NHS in terms of business turnover; its contracts are on a two-year basis and can be extended. The condom range has been increased to include 11 different products. These products are sold under the company's Condomania brand which is a well established brand. SHG has also been introducing new products in the areas of product hygiene for the NHS and diagnostic tests for NHS's GPs. Therefore its dependence on condom sales will

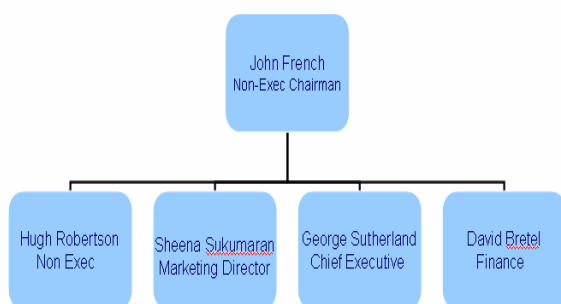
gradually decrease. Products involved include shower gel, shampoo, shaving cream, razor packs, etc.

This new range was launched in association with NHS England and now constitutes 45% of total sales. Its development has been driven by the fight against health-acquired infections such as MRSA ('superbug') infections, which cost the NHS £1bn a year. Recent products developed in this range are slightly more complex than the previous ones and include fragrance-free talc, shaving foam suitable for sensitive skin and a deodorant suitable for both men and women, Diagnostic tests are also being developed and include, in particular, a pregnancy diagnostic test to be used by GPs.

All products are mainly sold through the NHS and in catalogues and advertising. Marketing is focused on promotional and trade marketing and is at a much lower cost than marketing focused on end-consumers directly.

Management

SHG's management team is experienced and motivated.



SHG's chief executive and founder, George Sutherland, has 20 years' experience in the supply of products to the NHS. His previous companies include Nabisco Foods, Bristol-Myers Squibb, Unilever, Mates Healthcare and Ansell. He is also the company's majority shareholder.

The chairman, John French, has 40 years' experience as a businessman and runs a consultancy advising SMEs on flotation and fundraising matters. He is on the board of several listed companies – I-Financial Services Group and The Claims People Group - and chairs the PLUS Markets panel.

The finance director, David Bretel, retired in July 2008. SHG is currently seeking to replace him.

The marketing director, Sheena Sukumaran, has 11 years' experience in sexual health marketing and was responsible, with George Sutherland, for creating SHG's brand for condoms (Condomania).

The non-executive director, Hugh Robertson, has many years' experience in corporate law, specialising in mergers and acquisitions.

Main Milestones

Since SHG's flotation in January 2005 to date:

- Quality accreditation ISO 13485:2003 and 93/42 EEC directive for medical devices (safety and health regulation). ISO 9001:2000 audited and approved.
- Launched educational partnership with the Royal College of Nursing and the University of Greenwich.
- Contract won to supply patient care range to NHS England worth in excess of £0.6m over 3 years.
- Contract won to supply pre-operative razors to NHS England – potential £0.35m over 3 years.

In 2007

- Six new products added to sexual health contract in NHS England. New products being launched are generally higher-value and more sophisticated.
- First institutional investor, Majedie invests £150,000.

In 2008 - Achievements to date:

- Launch of new products to the NHS: two pregnancy diagnostic tests and two patient hygiene products; re-launch of the self-diagnostics range.
- Successful quality audit by SGS UK completed in June. This is a very important outcome for SHG as it establishes that the company has the capability to sell medical devices, based on its product recall capability in particular. SHG will therefore be able to continue to develop, manufacture, and distribute medical devices and diagnostics to the quality standards ISO 13485: 2003, 93/42/EEC directive and ISO 9001:2000.
- Launch of a £500,000 share and convertible bond issue, also in June, with £305,000 raised to date.

In the pipeline for 2008 & 2009:

- Launch of new professional diagnostics range.
- Launch of new patient hygiene products for the NHS.
- Acquisitions complementing the product range.

The year to March 2008

Sales breakdown by product group

	<u>2007A</u>	<u>2008A</u>	<u>2009E</u>
Condomania condoms	38.41%	32.20%	25.40%
Other SHG brands	29.26%	41.00%	52.50%
Distributed products	32.33%	26.80%	22.10%

Although the withdrawal of the Pasante acquisition is disappointing for SHG, the company has built a strong growth momentum which is likely to continue. Its sizeable 5% market share of the NHS condom market is a major strength. In addition, efforts made to widen its offering of branded products are also paying off.

As shown in the table above, SHG's own brands other than the Condomania condom brand should represent 52.5% of total revenues in FYE March 2009, compared with 29.3% in FYE March 2007. SHG's share of own

brands, which have higher margins than 'distributed products', i.e. third-party brands, is also rising.

SHG's results for FYE March 2008 are encouraging. Sales were up by 18% to £0.7m, after an 82.4% rise in 2007. Growth was mainly driven by a strong NHS demand, as sexual health and patient hygiene are top priorities of the NHS. Gross operating margin also slightly improved, from 44% to 45%, after a strong improvement in 2007 (2006: 33%). This was partly due to the rising proportion of higher-margin products such as patient hygiene products and of SHG-branded ones. Administrative costs were flat. Net loss for the year decreased by 24% – from £229,868 to £173,500.

P & L - Y/e March (£)	2007	2008
Turnover	604,223	711,386
% increase		17.7%
Purchases	337,171	390,550
Gross Profit	267,052	320,836
Gross Margin	44.2%	45.1%
Distribution costs	29,568	37,644
Administration expenses	392,326	394,334
Goodwill amortisation	24,670	24,670
Total overheads	446,564	456,648
% increase		2.3%
Other operating income	3,961	11,314
Operating result	-175,551	-124,498
Interest payable	54,782	50,843
Bank interest receivable	465	1,350
Net interest expense	54,317	49,493
Result on Ordinary Activities	-229,868	-173,991
No of shares 000	37,500	37,500
EPS p	-0.6	-0.5

Balance Sheet Y/e March (£)	2,007	2,008
Assets		
GW on Sutherland Group acquisition	395,070	369,421
Current assets:		
Bank	24,830	44,914
Trade debtors	143,172	163,693
Inventory	87,099	108,969
Total current assets	255,101	317,576
Total assets	650,171	686,997
Liabilities & equity		
Current liabilities	450,577	505,672
Due after one year	552,811	368,048
Total liabilities	1,003,388	873,720
Equity	-353,217	-186,723
Total liabilities & equity	650,171	686,997

CashFlow - Y/e March (£)	2007	2008
Cashflow from operating activities	-42,875	-197,665
Return on investments	-54,489	-49,493
Capex & financial investment	-1,100	-480
Cash outflow before financing	-96,457	-245,630
Financing	86,978	267,722
Increase in cash	-9,479	22,092

Recent Events and Conclusion

The £500,000 fund raising effort started last month has been successful so far, with £305,000 already raised, of which 2/3 in shares and 1/3 in convertible loan notes. (The share issue is still ongoing at 2p). Overall, SHG has now put in place an infrastructure which should enable it to increase its revenue size. It has an experienced management team, a number of contracts already in place with the NHS, a sizeable number of staff and warehousing space, and its recent fund raising supports its expansion in terms of funding its working capital needs. The increase in the size of the business should follow, as new products are added to the existing range. The company is also seeking to accelerate its growth further through acquisitions and has already identified a number of potential targets in the areas of sexual health, patient hygiene and female health. Expansion outside the UK should remain limited at this point in time. The company secured a contract to supply the State of Jersey as exclusive supplier at the end of 2007 but its current expansion plans are domestic otherwise, as its first priority is to exploit its competitive advantage in the UK as NHS supplier, together with the infrastructure put in place and recently strengthened, to achieve a sizeable and profitable operation.

We forecast a strong increase in revenues for both 2009 and 2010. The company appears generally in growth mode for 2009, and turnover in Q1 to 30 June 2008 showed a significant increase year on year, supported by rising demand for both existing and new products. Revenue growth should be mainly driven by volume growth but also by improving margins, as new products, with higher margins, are gradually added to NHS contracts, and own-brand products are increased. In addition, cost control should remain tight. The company should be able to break even relatively shortly, an achievement which would both boost its stock price and help it raise the funds needed to take its expansion to a further stage.

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