Global Specialists in Integrated Security Systems

Synectics plc

Interim Report for the six months ended 31 May 2019

Synectics plc is a leader in the design, integration, control and management of advanced surveillance technology and networked security systems

With over 30 years of field-proven experience, Synectics has acquired intimate knowledge of the unique customer requirements and priorities in commercial, public and industrial environments where security is critical to their operations.

Meeting the needs of highly demanding clients for Oil & Gas, Gaming, Transport & Infrastructure, and High Security & Public Space applications, Synectics engineers sector-specific, tailored security solutions that its customers rely upon to safeguard their people, facilities and assets – across the world.

Great technology, a flexible attitude and deep sector expertise – from decades of experience – are what set Synectics apart.

The world's leading oil & gas plants, casinos, transport operators and public authorities select Synectics.

Headlines

- Revenue £33.6 million (2018: £34.7 million)
- Profit before tax £1.2 million (2018: £1.5 million)
- Diluted EPS 6.1p (2018: 5.9p)
- Order book £28.2 million, like-for-like increase of 23% since the year end (£21.0 million)
- Strong net cash position
- Interim dividend raised to 1.3p per share (2018: 1.2p)
- Stronger performance expected in second half

"With full year results expected to be in line with market expectations, Synectics is in a strong position to capitalise on a number of exciting high profile projects and harness strategic growth opportunities aligned with the development of next-generation product capabilities."

Paul Webb
Chief Executive

In this report

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synecticsplc.com

Overview

At the Annual General Meeting on 25 April last, I reported that the Group's UK trading had begun to experience a pattern of order deferrals and customer-led delays in the progress of existing contracts that was likely to lead to profits being substantially more weighted to the second half of the current year than was initially anticipated. This apparent uncertainty among Synectics' private and particularly public sector customers in the UK continued in the remainder of the first half, though the impact was partly offset by positive developments elsewhere.

Synectics continued to enjoy strong revenues and profit contribution from global gaming surveillance systems, notably a large order in the half year from a substantial new customer in Macau. There was also a pick-up in business in high security prisons as well as in the pipeline of expected orders for important high security sites and infrastructure in the UK and continental Europe. Most significantly, Synectics' success in recently securing preferred bidder status for a major European transport infrastructure project described below provides further validation of the Group's progress towards its market objectives.

The Group's competitive position in these areas continues to benefit both from its focus on sophisticated high-end customers with increasingly specialised security and surveillance needs and from investment committed to enhancing Synectics' core technology.

Results

Synectics' revenue for the first half was £33.6 million, compared with £34.7 million in the same period last year. The Group recorded a consolidated underlying profit[1] of £1.2 million (2018: £1.5 million). There were no material non-underlying items, so profit before tax was also £1.2 million (2018: £1.5 million). This was the first period for which Synectics applied the new IFRS 15 accounting standard related to the timing of revenue recognition. The net impact of applying the new standard across the first half was relatively immaterial, resulting in a 2.8% increase in reported revenues and a benefit of £0.1 million to post-tax profits. The underlying diluted earnings per share[1] for the half year were 6.2p (2018: 5.9p).

More details on these results are set out in the divisional reports below.

Order intake was £37.6 million, representing a book-to-bill ratio of 1.15 and leaving the order book at 31 May 2019 at £28.2 million on a post-IFRS 15 basis. This represents a like-for-like increase of 23% from the position at the start of the financial year (£21.0 million).

Net cash at 31 May 2019 was £5.3 million. It remains the case that Synectics' businesses on average turn a relatively substantial portion of their profits into free cash flow, although short-term working capital balances can fluctuate significantly.

1 Underlying profit represents profit before tax and non-underlying items (which comprise amortisation of acquired intangibles). Underlying earnings per share are based on profit after tax but before non-underlying items.

Dividend

In view of Synectics' continuing profitability and strong balance sheet, the Board has decided to pay an increased interim dividend of 1.3p per share (2018: 1.2p) on 20 September 2019 to shareholders on the register on 23 August 2019.

Business Review

Systems

Synectics' Systems division provides specialist electronic surveillance systems, based on its own proprietary technology, to global end customers with large-scale highly complex security requirements, particularly for oil & gas operations, gaming, transport & infrastructure protection, and high security & public space applications.

£000	**Six months ended 31 May 2019**	Six months ended 31 May 2018	Year ended 30 November 2018
Revenue	**23,047**	24,276	48,923
Gross margin[2]	**39.3%**	38.9%	37.6%
Operating profit[2]	**2,357**	2,368	3,790
Operating margin[2]	**10.2%**	9.8%	7.7%

2 Before non-underlying items and Group central costs.

Once again, the Gaming surveillance sector was the largest contributor to the results of the Systems division. A highlight in the first half was the multi-million-pound contract win from a new customer to provide our proprietary Synergy 3 software platform to replace the surveillance system in a large, established gaming property in Macau. This customer has the potential to generate significant further revenue in the future.

Additionally within the Gaming sector, the division delivered new systems for existing customers in the US, and significant upgrades for existing customers in Singapore, the Philippines and the US. This level of repeat business from established customers continues to demonstrate the quality and durability of Synectics' long-term relationships.

The Group made significant progress in the half year in the strategically important target sectors of Transport & Infrastructure and High Security. These areas, which represent very large global market opportunities, achieved solid growth. Notable new contracts were won for Northern Power Grid (following on from Synectics' installations for National Grid, which continue to roll out), UK high security prisons and additions to our existing command and control systems for BVG, the Berlin transport authority. Most significantly, Synectics has recently been selected as preferred bidder for a large, multi-year contract for an enhanced Synergy system for a major European transport infrastructure project. Further details will be announced once the contract is finalised.

This positioning of Synectics' software systems as the customer's core command and control solution, covering operations and workflows as well as security, gives the Group not only a base on which to develop our next generation of large-scale applications, but also substantial credibility in bidding for other such systems in Europe and globally.

In the Oil & Gas surveillance sector, during the first half, the Group received its largest single order for some time, from ABB, a major European engineering group, for a new multi-site facility being developed by a national oil company in the Middle East. Significant follow-on orders were also won from existing customers in the Middle East and Asia. The overall market for oil & gas infrastructure remains subdued. Synectics' revenues remain well below historical levels, as a result of which our activities in the sector continued to trade at around break-even in the first half.

The UK bus and coach market, where Synectics has a strong footprint, remained weak, with new UK vehicle registrations continuing at the low level of late last year. Synectics' sector revenues for the half were down by 36% compared with the same period in 2018. Because swift action was taken late last year to reduce the cost base, activities in the sector were still marginally profitable despite that substantial drop in revenue. Notwithstanding the current market weakness, customers in this sector are showing considerable interest in Synectics' disruptive new Cloud-based on-vehicle surveillance solutions which, as they become established, could fundamentally change the dynamics of how such on-vehicle systems are managed.

As a whole, Synectics' Systems division's financial performance in the first half was roughly flat against the comparative period. However, this masks the substantial progress made in successfully increasing Synectics' penetration of our largest target market sectors, Transport & Infrastructure and High Security. In that respect, we believe that securing preferred bidder status for the major European transport infrastructure project referred to above is a critical milestone for the Group.

Integration & Managed Services

Synectics' Integration & Managed Services ('IMS') division is one of the leading UK providers of design, integration, turnkey supply, monitoring and management of large-scale electronic security systems. Its main markets are in critical infrastructure, public space and multi-site systems. Its capabilities include a nationwide network of service engineers, UK government security-cleared personnel and facilities, and an in-house 24-hour monitoring centre and helpdesk. The IMS division supplies proprietary products and technology from Synectics' Systems division as well as from third parties.

£000	**Six months ended 31 May 2019**	Six months ended 31 May 2018	Year ended 30 November 2018
Revenue	**10,799**	10,661	24,249
Gross margin[2]	**21.5%**	24.7%	22.8%
Operating profit[2]	**81**	330	967
Operating margin[2]	**0.8%**	3.1%	4.0%

2 Before non-underlying items and Group central costs.

Business Review continued

Integration & Managed Services continued

Profits of the IMS division for the first half showed a decline against the comparative period and, particularly, against the second half of last year. Management views this as primarily a timing issue, flowing from temporary order deferrals and customer-led delays on existing projects. That conclusion is backed up by a pipeline of expected near-term orders that has doubled since the beginning of the financial year.

The division's portfolio of clients has improved markedly in quality over the recent past, and is now much more successfully focused on its target market of large, sophisticated clients willing to engage in deeper partnership relationships. These relationships offer Synectics the opportunity to demonstrate over time the real benefits of the greater technical capabilities and understanding of through-life value that are our competitive advantages.

Many of these clients cannot be named for security reasons, but a few examples that can be named give an idea of the types of organisations that entrust their security to Synectics: the British Museum, Westminster Abbey, Queen Elizabeth Olympic Park, Royal Parks, Ministry of Defence, and various nuclear power installations.

Within the division's multi-site managed services operations, Synectics has secured a 100% renewal rate for significant long-term contracts expiring this year, and is looking forward to bringing additional new customers into its network.

Synectics' Integrated Systems business remains one of the UK's largest and most capable providers of security systems and services. The division is poised to produce much improved results in the second half.

Research & development

Expenditure on technology development during the six-month period was £1.5 million (2018: £1.5 million) of which £0.3 million (2018: £0.2 million) was capitalised and the remainder expensed to profit and loss. £0.2 million of previously capitalised development was amortised in the period. These figures are included within the results of the Systems division.

During the period, Synectics continued to extend its Synergy software platform and to further enhance its cyber security resilience. Synergy's newly developed Cloud-based video evidence management capability is starting to generate considerable interest.

As part of the Group's increased investment programme, more resources are being dedicated to its next-generation Synergy software solutions, with foundation work already well underway. We see increasing opportunities to capitalise on emerging software technology applications to expand Synectics' position at the forefront of the market for complex surveillance solutions, and are determined that the Group will invest appropriately to grasp those opportunities.

Outlook

Based on current order books and the pipeline of high probability new business, the Board expects continued excellent results from the Group's gaming surveillance activities in the second half. We also expect a significant improvement in revenue and profits from the IMS division as its healthy pipeline of seemingly imminent new business matures into orders and revenues.

The Board anticipates that consolidated results for the full year will be in line with market expectations though, as previously stated, we do caution that the second-half weighting inevitably increases the timing risks in management's forecasts.

Overall, we believe that Synectics' position in its marketplace continues to strengthen. As shown by recently securing preferred bidder status for a major European transport infrastructure project, there is growing evidence that the Group's substantial investment in new developments of its core products and technology is beginning to pay off as planned.

David Coghlan
Chairman

23 July 2019

Consolidated income statement

For the six months ended 31 May 2019

	Notes	Unaudited six months ended 31 May 2019 (IFRS 15) £000	Unaudited six months ended 31 May 2018 (IAS 18 & 11) £000
Revenue	3	**33,568**	34,740
Cost of sales		**(22,193)**	(22,667)
Gross profit		**11,375**	12,073
Operating expenses		**(10,107)**	(10,555)
Profit from operations, before non-underlying items		**1,268**	1,518
Non-underlying items[1]		**(12)**	(12)
Profit from operations		**1,256**	1,506
Finance income		**84**	92
Finance costs		**(122)**	(148)
Profit before tax		**1,218**	1,450
Income tax expense	5	**(183)**	(467)
Profit for the period attributable to equity holders of the Parent Company		**1,035**	983
Basic earnings per share	7	**6.2p**	5.9p
Diluted earnings per share	7	**6.1p**	5.9p
Underlying basic earnings per share	7	**6.2p**	6.0p
Underlying diluted earnings per share	7	**6.2p**	5.9p

1 Non-underlying items represent amortisation of acquired intangible assets.

Consolidated statement of comprehensive income

For the six months ended 31 May 2019

	Unaudited six months ended 31 May 2019 (IFRS 15) £000	Unaudited six months ended 31 May 2018 (IAS 18 & 11) £000
Profit for the period	**1,035**	983
Items that will not be reclassified subsequently to profit or loss		
Re-measurement gain on defined benefit pension scheme, net of tax	**84**	–
	84	–
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translation of foreign operations	**91**	143
Losses on a hedge of a net investment taken to equity	**(17)**	(11)
	74	132
Total comprehensive income for the period attributable to equity holders of the Parent Company	**1,193**	1,115

Consolidated statement of financial position
As at 31 May 2019

	Unaudited 31 May 2019 (IFRS 15) £000	Unaudited 31 May 2018 Restated (IAS 18 & 11) £000	30 November 2018 (IAS 18 & 11) £000
Non-current assets			
Property, plant and equipment	**2,752**	2,687	2,728
Intangible assets	**21,485**	21,558	21,488
Retirement benefit asset	**283**	289	182
Deferred tax assets	**774**	164	659
	25,294	24,698	25,057
Current assets			
Inventories	**10,247**	11,243	7,632
Trade and other receivables	**14,898**	21,387	20,395
Contract assets[1]	**10,472**	–	–
Tax assets	**97**	39	87
Cash and cash equivalents	**5,337**	9,891	8,114
	41,051	42,560	36,228
Total assets	**66,345**	67,258	61,285
Current liabilities			
Loans and borrowings	**–**	(825)	–
Trade and other payables	**(21,441)**	(25,355)	(19,324)
Contract liabilities[1]	**(3,072)**	–	–
Tax liabilities	**(457)**	(405)	(467)
Current provisions	**(58)**	(106)	(121)
	(25,028)	(26,691)	(19,912)
Non-current liabilities			
Provisions	**(7)**	(85)	(7)
Deferred tax liabilities	**(662)**	(259)	(646)
	(669)	(344)	(653)
Total liabilities	**(25,697)**	(27,035)	(20,565)
Net assets	**40,648**	40,223	40,720
Equity attributable to equity holders of the Parent Company			
Called up share capital	**3,559**	3,559	3,559
Share premium account	**16,043**	16,043	16,043
Merger reserve	**9,971**	9,971	9,971
Other reserves	**(1,582)**	(1,807)	(1,748)
Currency translation reserve	**1,139**	886	1,065
Retained earnings	**11,518**	11,571	11,830
Total equity	**40,648**	40,223	40,720

1 Contract assets and contract liabilities arise following the adoption of IFRS 15 on 1 December 2018. See note 8.

Consolidated statement of changes in equity
For the six months ended 31 May 2019

	Called up share capital £000	Share premium account £000	Merger reserve £000	Other reserves £000	Currency translation reserve £000	Retained earnings £000	Total £000
At 1 December 2017[1]	3,559	16,043	9,971	(2,185)	754	12,612	40,754
Restatement (see note 4)	–	–	–	–	–	(1,183)	(1,183)
At 1 December 2017 (restated)	3,559	16,043	9,971	(2,185)	754	11,429	39,571
Profit for the period	–	–	–	–	–	983	983
Other comprehensive income							
Currency translation adjustment	–	–	–	–	132	–	132
Total other comprehensive income	–	–	–	–	132	–	132
Total comprehensive income for the period	–	–	–	–	132	983	1,115
Dividends paid	–	–	–	–	–	(498)	(498)
Credit in relation to share-based payments	–	–	–	–	–	35	35
Share scheme interests realised in the period	–	–	–	378	–	(378)	–
At 31 May 2018[1] (restated, see note 4)	3,559	16,043	9,971	(1,807)	886	11,571	40,223
Profit for the period	–	–	–	–	–	552	552
Other comprehensive income							
Currency translation adjustment	–	–	–	–	179	–	179
Re-measurement loss on defined benefit pension scheme, net of tax	–	–	–	–	–	(97)	(97)
Total other comprehensive income	–	–	–	–	179	(97)	82
Total comprehensive income for the period	–	–	–	–	179	455	634
Dividends paid	–	–	–	–	–	(201)	(201)
Credit in relation to share-based payments	–	–	–	–	–	31	31
Share scheme interests realised in the period	–	–	–	59	–	(26)	33
At 30 November 2018[1]	3,559	16,043	9,971	(1,748)	1,065	11,830	40,720
IFRS 15 opening balance adjustment (see note 8)	–	–	–	–	–	(808)	(808)
Tax on IFRS 15 opening balance adjustment	–	–	–	–	–	115	115
At 1 December 2018[2]	3,559	16,043	9,971	(1,748)	1,065	11,137	40,027
Profit for the period	–	–	–	–	–	1,035	1,035
Other comprehensive income							
Currency translation adjustment	–	–	–	–	74	–	74
Re-measurement gain on defined benefit pension scheme, net of tax	–	–	–	–	–	84	84
Total other comprehensive income	–	–	–	–	74	84	158
Total comprehensive income for the period	–	–	–	–	74	1,119	1,193
Dividends paid	–	–	–	–	–	(590)	(590)
Credit in relation to share-based payments	–	–	–	–	–	18	18
Share scheme interests realised in the period	–	–	–	166	–	(166)	–
At 31 May 2019[2]	**3,559**	**16,043**	**9,971**	**(1,582)**	**1,139**	**11,518**	**40,648**

1 Prepared under IAS 18 and IAS 11.

2 Prepared under IFRS 15.

Consolidated cash flow statement

For the six months ended 31 May 2019

	Unaudited six months ended 31 May 2019 (IFRS 15) £000	Unaudited six months ended 31 May 2018 (IAS 18 & 11) £000
Cash flows from operating activities		
Profit for the period	**1,035**	983
Income tax expense	**183**	467
Finance income	**(84)**	(92)
Finance costs	**122**	148
Depreciation and amortisation charge	**496**	668
Loss on disposal of non-current assets	**–**	14
Unrealised currency translation losses	**23**	11
Net movement in provisions	**(63)**	(59)
Share-based payment charge	**18**	35
Operating cash flows before movement in working capital	**1,730**	2,175
Increase in inventories	**(185)**	(1,733)
(Increase)/decrease in trade, other and contract receivables	**(8,051)**	3,085
Increase in trade, other and contract payables	**5,121**	2,728
Cash generated from operations	**(1,385)**	6,255
Tax paid	**(198)**	(216)
Net cash (used in)/from operating activities	**(1,583)**	6,039
Cash flows from investing activities		
Purchase of property, plant and equipment	**(267)**	(152)
Capitalised development costs	**(265)**	(180)
Purchased software	**(5)**	(53)
Net cash used in investing activities	**(537)**	(385)
Cash flows from financing activities		
Repayment of borrowings	**–**	(75)
Interest paid	**(38)**	(56)
Dividends paid	**(590)**	(498)
Net cash used in financing activities	**(628)**	(629)
Effect of exchange rate changes on cash and cash equivalents	**(29)**	145
Net (decrease)/increase in cash and cash equivalents	**(2,777)**	5,170
Cash and cash equivalents at the beginning of the period	**8,114**	4,721
Cash and cash equivalents at the end of the period	**5,337**	9,891

1 General information

These consolidated interim financial statements were approved by the Board of Directors on 22 July 2019.

2 Basis of preparation

These consolidated interim financial statements of the Group are for the six months ended 31 May 2019.

The comparative figures for the financial year ended 30 November 2018 are not the Group's statutory accounts for that financial year. Those statutory accounts have been reported on by the Group's auditor and delivered to the Registrar of Companies. The report of the auditor was (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report and (iii) did not contain a statement under section 498 of the Companies Act 2006.

The condensed consolidated interim financial statements for the six months to 31 May 2019 do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the Group's annual financial statements as at 30 November 2018.

The condensed consolidated interim financial statements for the six months to 31 May 2019 have not been audited or reviewed by an auditor pursuant to the Auditing Practices Board guidance on Review of Interim Financial Information.

The condensed consolidated interim financial statements for the six months to 31 May 2019 have been prepared on the basis of the accounting policies expected to be adopted for the year ending 30 November 2019. These are anticipated to be consistent with those set out in the Group's latest annual financial statements for the year ended 30 November 2018, with the exception of the adoption of new and amended standards as set out below. These accounting policies are drawn up in accordance with adopted International Accounting Standards ('IAS') and International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board and adopted by the EU.

Significant accounting policies

AIM-listed companies are not required to comply with IAS 34 'Interim Financial Reporting' and accordingly the Company has taken advantage of this exemption.

New and amended standards adopted by the Group

A number of new or amended standards became applicable for the current reporting period and the Group changed its accounting policies and, where applicable, made retrospective adjustments as a result of adopting:

– IFRS 9 'Financial Instruments'; and

– IFRS 15 'Revenue from Contracts with Customers'.

Following the adoption of IFRS 15 'Revenue from Contracts with Customers', the Group continues to consider revenue recognition as one of its critical accounting policies and estimates, owing to the complexity, judgement and estimation in its application and impact on the financial statements. Note 8 provides more details on the Group's application of the new accounting standards.

3 Segmental analysis

Revenue by operating segment

Revenue	**Unaudited six months ended 31 May 2019 £000 (IFRS 15)**	Unaudited six months ended 31 May 2018 £000 (IAS 18 & 11)
Systems	**23,047**	24,276
Integration & Managed Services	**10,799**	10,661
Total segmental revenue	**33,846**	34,937
Reconciliation to consolidated revenue:		
Intra-Group sales	**(278)**	(197)
	33,568	34,740

Underlying operating result by operating segment

Underlying operating profit	**Unaudited six months ended 31 May 2019 £000 (IFRS 15)**	Unaudited six months ended 31 May 2018 £000 (IAS 18 & 11)
Systems	**2,357**	2,368
Integration & Managed Services	**81**	330
Total segmental underlying operating profit	**2,438**	2,698
Reconciliation to consolidated underlying operating profit:		
Central costs	**(1,170)**	(1,180)
	1,268	1,518

Underlying operating profit from operations is reconciled to total profit from operations as follows:

	Unaudited six months ended 31 May 2019 £000 (IFRS 15)	Unaudited six months ended 31 May 2018 £000 (IAS 18 & 11)
Underlying operating profit	**1,268**	1,518
Non-underlying items	**(12)**	(12)
	1,256	1,506

4 Restatement of primary statements for the year ended 30 November 2017

Due to the continued pressure on the UK on-vehicle sector, caused by a further significant decline in new bus registrations, combined with the lost renewal of a long-term installation and support contract with a major customer, management performed a review of the business and its cost base during 2018. This review flagged some inappropriate procedures within this business, resulting in the reassessment of the value of the stock used in on-vehicle activities and their accounting treatment. The re-evaluation of stock led to a significant one-off write down and management determined that an element of the write down should have been included in the results of previous years.

It was determined by the Board of Directors that adjustments should be made to restate the results for the year ended 30 November 2017 to reflect the actual position and performance of the Group for that year.

The adjustments to the financial statements were as follows:

	Year ended 30 November 2017 £000	Years ended on or before 30 November 2016 £000	Total £000
Exceptional write down of inventory relating to UK on-vehicle	549	732	1,281
Exceptional tax credit in relation to the write down of inventory	(98)	–	(98)
	451	732	1,183

The comparative Consolidated statement of financial position has been restated to reflect the impact on the opening position.

5 Income tax expense

The income tax expense for the period is based on the estimated rate of corporation tax that is likely to be effective for the year to 30 November 2019.

6 Dividends

An interim dividend of 1.3p per share (2018: 1.2p), totalling approximately £223,000, will be paid on 20 September 2019 to shareholders on the register on 23 August 2019.

7 Earnings per share

Earnings per share are as follows:

	Unaudited six months ended 31 May 2019 Pence per share	Unaudited six months ended 31 May 2018 Pence per share
Basic earnings per share	**6.2**	5.9
Diluted earnings per share	**6.1**	5.9
Underlying basic earnings per share	**6.2**	6.0
Underlying diluted earnings per share	**6.2**	5.9

7 Earnings per share continued

The calculations of basic and underlying earnings per share are based upon:

	Unaudited six months ended 31 May 2019 £000	Unaudited six months ended 31 May 2018 £000
Earnings for basic and diluted earnings per share	**1,035**	983
Non-underlying items	**12**	12
Impact of non-underlying items on tax expense for the period	**(4)**	(4)
Earnings for underlying basic and underlying diluted earnings per share	**1,043**	991

	000	000
Weighted average number of ordinary shares – basic calculation	**16,771**	16,554
Dilutive potential ordinary shares arising from share options	**123**	183
Weighted average number of ordinary shares – diluted calculation	**16,894**	16,737

8 Change in accounting policies

IFRS 15 'Revenue from Contracts with Customers'

Background

IFRS 15 sets out the requirements for recognising revenue and costs from contracts with customers and includes extensive disclosure requirements.

The standard requires entities to apportion revenue earned from contracts to individual performance obligations, on a relative stand-alone basis, based on a five-step model.

As disclosed in our 2018 Annual Report and Accounts the Group has adopted the standard on a modified retrospective basis and has recognised the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings at 1 December 2018. Under this transition method:

- the standard has been applied only to contracts in progress but not completed at the date of initial application;
- for contracts that were modified before 1 December 2018, the Group has reflected the aggregate effect of all of the modifications that occurred before this date at 1 December 2018;
- prior year comparatives have not been restated for the effect of IFRS 15 but, instead, opening retained earnings at 1 December 2018 have been restated for the full cumulative impact of adopting this standard; and
- for the period ended 31 May 2019 a reconciliation has been provided of the primary financial statements under IFRS 15 to those that would have been reported under IAS 18 and IAS 11.

Financial impact and changes to accounting policies

Applying the modified retrospective method, a cumulative catch-up adjustment of £0.7 million was recognised as a reduction to the opening balance of retained earnings in the Consolidated Statement of Changes in Equity for the year ended 30 November 2018.

8 Change in accounting policies continued

Input method – uninstalled goods

Prior to the adoption of IFRS 15, where revenue and profits attributable to contracts were recognised as the contracts proceeded in proportions relevant to their stage of completion based on costs incurred as a proportion of estimated total contract costs, revenue and profits could be recognised on costs that did not necessarily transfer control of the goods or services to the customer.

Under IFRS 15, inputs that do not represent the entity's performance in transferring control of goods or services to the customer must be excluded from the input method calculation of the stage of completion. This means that revenues and related profits have been reversed in the cumulative catch-up adjustment. The following line items in the Consolidated Statement of Financial Position as at 30 November 2018 have been impacted as a result of the adjustment:

	At 30 November 2018 as published £000	Cumulative catch-up adjustment £000	At 1 December 2018 £000
Non-current assets			
Deferred tax assets	659	115	774
Current assets			
Inventories	7,632	2,413	10,045
Trade and other receivables	20,395	(3,221)	17,174
Net assets	40,720	(693)	40,027
Equity attributable to equity holders of the Parent Company			
Retained earnings	11,830	(693)	11,137
Total equity	40,720	(693)	40,027

Revenue and profit recognition

Upon approval by the parties to contract, the contract is assessed to identify each promise to transfer a distinct good or service to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer, and if they are separately identifiable in the contract.

The Group has determined that most of its contracts (both installation and maintenance) include a single performance obligation as the promises within the contracts are generally not separately identifiable within the contract.

In addition, the Group has determined that most of its contracts satisfy the over time criteria within IFRS 15, either because the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date (typically installation contracts) or because the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs (typically maintenance or support contracts).

The determination of the accounting treatment as a single performance obligation recognised over time does not change the previously adopted accounting treatment and therefore the change is not material. There was no transition impact at 1 December 2018.

8 Change in accounting policies continued

Costs of obtaining a contract

The incremental costs of obtaining a contract with a customer are recognised as an asset if the Group expects to recover them. The Group incurs costs such as bid cost, legal fees and sales commission when it enters into a new contract.

Judgement is applied by the Group when determining what costs qualify to be capitalised in particular when considering whether these costs are incremental and whether these are expected to be recoverable. For example, the Group considers which type of sales commissions are incremental to the cost of obtaining specific contracts and the point in time when the costs will be capitalised.

The Group has determined that sales commissions that are directly related to winning a specific contract may be capitalised as a contract asset.

The Group applies the practical expedient within IFRS 15 not to capitalise costs on contracts that are less than one year in length.

Costs incurred prior to winning a contract are not capitalised, but expensed as incurred.

The change to the accounting treatment is not material and there was no transition impact at 1 December 2018.

Warranty arrangements

The Group provides both assurance and service-type warranties. Assurance-type warranties will continue to be accounted for in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets', consistent with previous practice. Under IFRS 15, revenue in relation to service-type warranties will be deferred over the term of the warranty and no cost provision will be made under IAS 37. Whilst this is a change to the treatment of our service-type warranties, the amounts are not material and there was no transition impact at 1 December 2018.

Balance sheet reclassification – contract assets and contract liabilities

IFRS 15 requires any unconditional rights to consideration to be disclosed as a receivable and any conditional rights to consideration to be disclosed separately as a contract asset. In addition, any obligation of the Group to transfer goods or services to a customer for which consideration has already been received is disclosed separately as a contract liability.

At the date of initial application, the following presentation and classification changes were made to the Consolidated Statement of Financial Position as a result of applying IFRS 15:

- "Amounts recoverable on contracts" of £5.4 million (after applying the cumulative catch-up adjustment) classified within "Trade and other receivables" representing conditional rights to consideration were reclassified to "Contract assets".
- "Deferred income" of £3.0 million classified within "Trade and other payables" was reclassified to "Contract liabilities".

Software licences

The Group has determined that sales of software licences are not distinct within the context of the contract and are not the predominant component of the combined performance obligation. Therefore, revenue in relation to software licences is recognised as part of the single performance obligation. There was no transition impact at 1 December 2018.

8 Change in accounting policies continued

Consolidated income statement restatement under IFRS 15

The following shows a reconciliation of the Consolidated Income Statement for the period ended 31 May 2019 under IFRS 15 to those results that would have been reported under IAS 18 and IAS 11.

	Unaudited six months ended 31 May 2019 (IAS 18 & 11) £000	Impact of IFRS 15 £000	**Unaudited six months ended 31 May 2019 (IFRS 15) £000**
Revenue	32,655	913	**33,568**
Cost of sales	(21,449)	(744)	**(22,193)**
Gross profit	11,206	169	**11,375**
Operating expenses	(10,107)	–	**(10,107)**
Profit from operations, before non-underlying items	1,099	169	**1,268**
Non-underlying items	(12)	–	**(12)**
Profit from operations	1,087	169	**1,256**
Finance income	84	–	**84**
Finance costs	(122)	–	**(122)**
Profit before tax	1,049	169	**1,218**
Income tax expense	(147)	(36)	**(183)**
Profit for the period attributable to equity holders of the Parent Company	902	133	**1,035**

The increase to revenue of £913,000 and resulting profit before tax of £169,000 relates to the change in accounting treatment in relation to inputs that do not represent the entity's performance in transferring control of goods or services to the customer being excluded from the input method calculation of the stage of completion, as described above.

IFRS 9 'Financial Instruments'

IFRS 9 introduces an expected credit loss model on impairment that replaces the incurred loss impairment model used in IAS 39. The expected credit loss model is forward looking and eliminates the need for a trigger event to have occurred before credit losses are recognised.

The Group has considered a range of information, including historical trade receivable losses and current market conditions, and has determined that it is not materially affected by its adoption. The Group regularly reviews the credit limits it offers existing customers and conducts further credit checks where it deems appropriate.

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