MEARS

# Making partnerships work

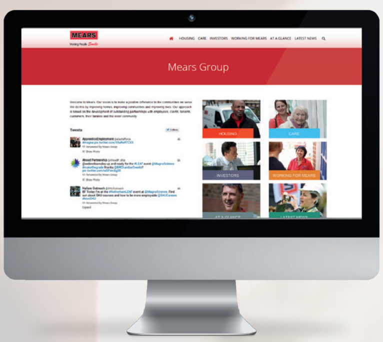
**Mears Group PLC**
Annual report and accounts 2014

# Providing partnerships through our depth and breadth of services.

At Mears, we are addressing some of the biggest challenges our country faces: quality social housing, building communities and providing exceptional care.

In partnership with our Social Housing clients, we maintain, repair and upgrade the homes of hundreds of thousands of people in communities from remote rural villages to large inner-city estates.

Our Care teams provide support to around 20,000 people on a daily basis, enabling older and disabled people to continue living in their own homes.

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## Strategic report



## Corporate governance



## Financial statements



## Shareholder information

# Highlights of the year

## Operational highlights

- Strategy focused on two growth sectors
- Differentiated service delivery continues to drive organic growth
- Outlook is positive and we are well placed for continued growth:
  - Further investment in Mears Nurseplus infrastructure, driving organic growth
  - Emergence of new commissioning models in Care market; Torbay success represents a crucial milestone
  - Extension of Social Housing activities into broader housing management; Omega performing strongly
  - Continue to drive margin improvements from enlarged Social Housing business
  - Order book of £3.3 billion; 92% visibility of consensus forecast revenues for 2015 and 82% for 2016

Read more about our operational performance on **pages 26 to 33**

## Financial highlights

- Revenue of £838.7m (2013: £865.6m), following the anticipated normalisation of the ex-Morrison revenue run-rate
- Social Housing operating margin increased to 4.8% (2013: 4.5%), driven primarily by the improving margins being generated from the ex-Morrison business
- Record profit before tax of £42.0m (2013 continuing activities: £39.3m), growth of 7%
- Normalised diluted EPS of 32.20p (2013: 28.06p), growth of 15%
- Excellent EBITDA cash conversion from continuing activities of 96% (2013: 103%)
- New contract wins in excess of £300m:
  - Social Housing awards of £170m with a conversion rate of 35% (2013: £420m and 32%)
  - Care awards of £130m with a conversion rate of 73% (2013: £96m and 69%)
- Strong balance sheet with average net debt of £59.0m (2013: £70.0m); net cash at 31 December of £3.8m (2013: net debt £0.4m) and closing core debt of £75.0m following acquisition of Omega
- Progressive dividend policy, increasing total dividend by 14%, closely tracking growth in earnings, to 10.0p per share (2013: 8.8p)

Read more about our financial performance on **pages 34 to 37**

**Group revenue** (£m)†

**£838.7m**

| | |
|---|---|
| 2014 | 838.7 |
| 2013 | 865.6 |
| 2012 | 617.2 |
| 2011 | 523.5 |
| 2010 | 479.8 |

**Group operating profit** (£m)*†

**£43.0m**

| | |
|---|---|
| 2014 | 43.0 |
| 2013 | 41.1 |
| 2012 | 32.8 |
| 2011 | 32.4 |
| 2010 | 29.8 |

**Dividend per share** (p)

**10.00p**

| | |
|---|---|
| 2014 | 10.00 |
| 2013 | 8.80 |
| 2012 | 8.00 |
| 2011 | 7.50 |
| 2010 | 6.75 |

**Normalised diluted earnings per share** (p)**

**32.20p**

| | |
|---|---|
| 2014 | 32.20 |
| 2013 | 28.06 |
| 2012 | 25.60 |
| 2011 | 26.01 |
| 2010 | 23.38 |

* Before acquisition intangible amortisation and exceptional costs.

** Before acquisition intangible amortisation and exceptional costs, with an adjustment to reflect a full tax charge.

† Excludes discontinued M&E activities.

# Mears at a glance

## We repair and maintain over 700,000 of the 5 million Social Homes in the UK.

## Social Housing

Our clients are increasingly looking for partners who can operate strategically as well as operationally across a range of housing services. Mears has extended its core reactive and planned maintenance offering to include housing management to support clients in delivering more integrated solutions, aligned to their strategic challenges.

We provide rapid response and planned maintenance services to Local Authorities and other Registered Social Landlords.

**In focus**

Mears and North Lanarkshire Council, a unique JV, and our acquisition of Omega Lettings.

**pages 29 and 30**

| Revenue | Employee numbers | Office locations |
|---|---|---|
| £715m | c.5,600 | 180 |

### Our breadth of services:

Repairs

Estate management

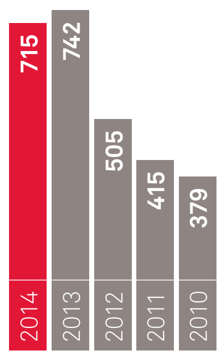
Planned and cyclical maintenance

Fuel poverty initiatives

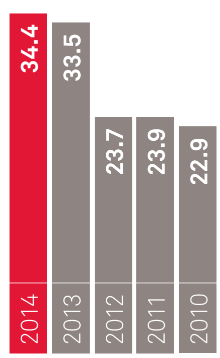
Grounds maintenance


Capital projects

Revenue (£m)




Operating profit (£m)




### Our customers:

- Local Authorities
- Registered Social Landlords
- Private Landlords
- Tenants and service users
- Community groups

Read more about our Social Housing markets on **page 08**

**We provide personal care to over 20,000 elderly and disabled people in their own home, on a daily basis.**

# Care

We have a comprehensive range of domiciliary care and complex care services enhanced by the ability to deliver a range of housing adaptations and assistive technology such as telecare. The range of services enables us to deliver broad solutions to the independent living challenges faced by so many elderly people, as well as younger people with physical or mental disabilities.

We provide high quality and flexible care for older and disabled people who want to continue living in their own homes.

## In focus

A new commissioning model is transforming the sector and Mears Nurseplus, working in partnership with the NHS.

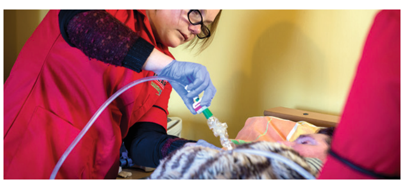
**Pages 31 and 32**

| Revenue | Employee numbers | Office locations |
|---|---|---|
| £124m | c.7,400 | 120 |

## Our breadth of services:

Independent living service

Aids and adaptations



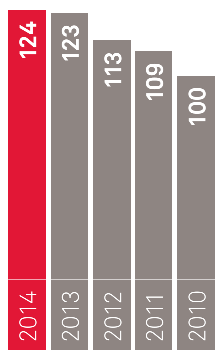
Complex care

Assistive technology (telecare)

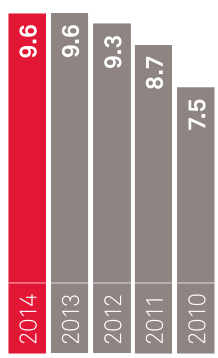
Live-in care

Extra care

Revenue (£m)




Operating profit (£m)




## Our customers:

- Local Authorities
- NHS
- Charities
- Community groups
- Elderly people
- People with learning and physical disabilities

Read more about our Care markets on **page 10**

# Chairman's statement

We have made excellent progress in strengthening our relative competitive position in our two growth markets.

**Bob Holt**
Chairman

## In summary

**The Board remains confident** in our growth markets and consequently expects to be able to continue to follow a progressive dividend policy.

**We expect our Social Housing business to continue to grow** through further contract wins, underpinned by our differentiated market-leading service delivery.

**We believe the opportunities for us in Social Housing remain very strong** as our clients seek broader solutions to their increasingly complex housing challenges; consequently, we will look to add scale, depth and breadth to our housing management offering.

**We are confident that further opportunities in Care will arise** from health and social care outsourcing and the implementation of new localised commissioning models. Consequently, we will continue to move further up the acuity chain, with an increased focus upon organic growth, extending our Nurseplus model across our customers, supported by in-fill acquisitions.

I am pleased to announce record profits for the year to 31 December 2014 and delighted to report excellent progress, particularly around strengthening our competitive position in our two growth markets. We expected a reduction in Social Housing revenues given the normalisation of the Morrison run-rate. Group revenue amounted to £838.7m (2013: £865.6m), however we significantly enhanced our future growth prospects through the development of our Housing Management business, both through the acquisition of Omega and through organic investment in people and systems.

We continue to drive margin improvements, with operating profit before amortisation increasing by 5% to £43.0m (2013, before exceptional costs: £41.1m). Group operating margin increased to 5.3% (2013: 5.0%) driven primarily by the improving contract margins being generated from the ex-Morrison business. Normalised diluted earnings per share on all activities was up 15% to 32.20p (2013: 28.06p) and up 7% on continuing activities (2013: 30.08p). We have 92% visibility of consensus forecast revenue for the current year and in excess of 82% visibility for 2016.

We have continued to deliver strong cash flows with cash generated from continuing operations as a proportion of EBITDA at 96% (2013: 103%) and net cash reported at the year end. Average net debt for the year, before the acquisition of Omega, was £59m (2013: £70m) demonstrating continuing strong cash management.

We completed the acquisition of Omega in October 2014. The shortage of affordable, safe and secure housing is a significant challenge faced by our clients today. I anticipate Local Authorities having increased responsibility resulting in the need to provide more social homes and remove the reliance upon those private landlords who provide properties which are not of a uniformly high standard. Omega is a logical extension to our current offering; it will enhance our ability to work with housing providers to improve the delivery of housing and property management. I am excited by the medium-term organic growth opportunities that will be forthcoming through the development and integration of the Omega business model. I know that our clients welcome our involvement in their challenge to professionalise and stabilise financially their housing management activities.

We are delighted to announce that we have been appointed preferred bidder with the Department for Communities & Local Government (DCLG) for the commercialisation of its Planning Portal. The Planning Portal is a web-based one-stop shop for advice and guidance on planning, building regulations and appeals. It is the sole electronic means to submit a planning application, with links to all Local Authorities in England and Wales. DCLG believes the portal has commercial value as well as opportunities to identify other revenue streams, particularly as some 80% of planning applications go through the portal. It is on this basis that DCLG sought a partner to take on the running costs of the service and to help transform it into a commercial business. We intend to take a 75% stake in the venture with DCLG. This partnership will not only strengthen our housing management service with materially improved customer access but it will also provide an opportunity to bring further services to our clients.

Although our Social Housing order intake was impacted temporarily by a quieter period of new bidding opportunities, our conversion of new bidding opportunities reported an increase to 35%. This is an important metric and one that will serve us well, once the bid pipeline opportunities return to historic levels.

In Care, as a robust high quality provider at the forefront of change in the sector, we remain well placed strategically to take advantage of the long-term opportunities. I am delighted at the success we have achieved in new contract bidding. Importantly, we are seeing a continued move away from frameworks towards strategic partnerships, often with longer contract lengths and fewer providers. This will benefit us disproportionately to the rest of the sector given our long-term partnership ethos. Our award of the Torbay & Southern Devon NHS Trust contract for Living Well@Home Services is another crucial milestone in the evolution of the sector and for Mears' position within it. We will deliver a full range of community-based services including personal care and more complex services, such as healthcare at home, community support, mental health and learning disabilities support. The contract will be for a minimum five year term with three potential one-year extensions and is due to commence in April 2015. It has an estimated contract value of £50m. We understand that this is the first time a contract of this type has been awarded to a single prime contractor in the UK.

## Dividend

The Board remains confident in the future opportunities in our growth markets and consequently it expects to be able to continue to follow a progressive dividend policy. The Board has recommended a final dividend of 7.15p per share which, combined with the interim dividend, gives a total dividend for the year of 10.00p (2013: 8.80p), a 14% increase. The dividend is payable, subject to shareholder approval at the Company's Annual General Meeting on 3 June 2015, on 2 July 2015 to shareholders on the register on 12 June 2015. The dividend is covered over three times by the normalised diluted earnings per share. The Board regularly reviews the Group's distribution policy to maximise returns to shareholders whilst maintaining a prudent capital structure and investing for growth.

## Corporate governance and risk management

The Board continues to set itself high standards of corporate governance. Our Corporate Governance Report issued within our Annual Report will detail how we approach governance and the areas of focus for the Board in 2014 and into the future.

We have continued to invest resources in our risk management process. During the year, we have redrafted the Group's policy on fraud and anti-bribery. The revised policy enhances the process for continual review of our control effectiveness in this area. Moreover, we have delivered a fraud and anti-bribery training programme informing staff of their legal duties and to ensure that they are aware of our policies.

We have reviewed and updated the Group's risk register. The senior management teams play a central role in reviewing and challenging the Group's risks. The Group risk team presented risk management training modules to all levels of management, via the Group development programme, to further increase our strong risk management ethos. We engaged KPMG as our internal audit partner which completed a detailed audit programme on the Group's financial risks.

## Board evaluation and effectiveness review

Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis. This year's review was externally facilitated, with an independent reviewer meeting with all Board members individually. The Directors were asked for their views on a broad range of areas including Group strategy, independence, experience, effectiveness, shareholders and the interaction between Board members. Some improvements were proposed and implemented but overall it was concluded that the Board was working in an effective and efficient manner.

## Our people

I commend our employees for their commitment and energy throughout another significant year for the Group. I continue to be impressed by their quality, professionalism and loyalty.

We have continued to invest in the future generation. At the end of 2013, we launched the National Apprenticeship Scheme, a Group-wide approach to the end-to-end apprenticeship process. This scheme, which has now been in place for a full twelve months, provides a best practice approach to recruitment with the aim of appointing the best quality candidates for our business. We are pleased to have been recognised as one of the Top 100 employers of apprentices in the UK.

Our corporate strategy includes the establishment of an internal talent scheme, which recognises the potential of our existing workforce and maximises the likelihood of retaining our most promising people. During 2014, we made significant progress in our management development programme, including senior leadership, branch manager and supervisory levels. These bespoke programmes call on internal experts and external specialists in order to create an effective scheme, combining the best of Mears with the latest in leadership thinking and wider industry best practice.

I look forward to bringing you news of further success during the coming year.

**R Holt**
**Chairman**
bob.holt@mearsgroup.co.uk
17 March 2015

# Business model

Our business model is based on our values of innovation, partnership and leadership. Through leveraging our breadth of capabilities, we create long-term value for our stakeholders.


We have a robust risk management process in place. Read more on **page 22 to 25**

People are a major factor behind Mears' success. Read more on **page 16 to 17**

Our key performance indicators are detailed on **page 14 to 15** and are focused on ensuring the robustness of our business model and the achievement of our strategic goals.

## Our customers

Our customers are at the centre of our business. We feel a strong sense of responsibility to improve the long-term prospects of the communities we serve by improving their homes, their neighbourhoods and their lives. Our business is based upon the development of outstanding partnerships with clients, tenants, service users, their families and the wider communities. We partner with our customers in Social Housing and Care and secure contracts for, on average, six years and three years respectively. Our customers choose us for the quality of our service delivery, which remains our key differentiator.

## Our people

A major factor behind Mears' success is our commitment to the training and development of our staff. We recognise our staff as our greatest asset and that is why Mears' employees are skilled in both delivering an excellent service whilst showing a strong customer service ethos and an empathy for our service users.

## Strong service delivery ethos

Our service delivery leads the market. We set ambitious KPIs, consistent with our expectations to maintain and extend our market leadership. We have a long track record of meeting these targets, which are cascaded down to people at every level of the organisation.

## Robust IT systems

Our performance is built on a bedrock of first class, in-house IT platforms giving market-leading capability. Our processes and systems are developed with a focus upon providing excellent visibility of operational and financial performance at a job and contract level.

## Our communities

We work in some of the most socially deprived areas of the country and we feel a strong sense of responsibility towards finding ways to improve the long-term prospects of the people who live in these communities. This philosophy has always been at the heart of the Group.

## Innovation

The challenge of delivering service improvements at lower cost requires innovative thinking and extensive consultation between all stakeholders. We create, discuss, lead and roll out best practice in our markets.

## Leadership

The growth and change in our business requires investment in leadership at every level and we work hard to ensure that there is a clear succession planning in place. We believe that our leadership team has never been stronger and we continue to attract the best talent in both of our sectors to Mears.

## Partnership

We focus on long-term customer relationships with shared goals and trusted relationships. We recognise that, for our customers, we have a responsibility beyond just repairing a home or delivering a good standard of personal care.

We have key strategic partnerships with a number of our suppliers. We work closely with them to develop innovative services and processes that integrate with our core systems.

## Creating long-term shareholder value

We have grown through a combination of organic growth supplemented through acquisitions. The Board remains confident in our growth markets and consequently expects to be able to continue to follow a progressive dividend policy.

We have a clear and effective strategy to support our business model.
Read more on **pages 12 to 13**

# Our markets

We operate in robust and defensive markets where spend is largely non-discretionary.

## The Social Housing market

The Social Housing market continues to develop strongly with demographic, supply-side and economic change drivers for growth.

### Change drivers

**Demographic factors**

- The demand for housing continues to exceed supply. There are 1.9m households on housing lists across the UK, which is driving the development of new affordable homes both for social and market rent.
- An ageing population is putting pressure on the need for more homes as we move to housing four generations simultaneously as opposed to three.
- A growing population – it is projected to increase at a rate of 450,000 per annum over the next decade.
- Over the same period, in England, new households will form at a rate of 221,000 a year.

**Supply-side**

- Housing Associations continue to see mergers as a mechanism to secure sustainable businesses, particularly where aspects of poor performance or insufficient scale are in play.
- Housing Associations are still very active developers of new housing and have successfully absorbed reduced Government funding through increased surpluses.
- Local Authorities are now building new homes in increasing numbers; even those that have sold their housing stock are now considering building or acquiring housing again.
- Most commentators now agree the nation needs in excess of 240,000 new homes a year.

**Economic**

- The 2012 reform of the Housing Revenue Account (HRA) system in Local Government, with the subsequent long-term security around rental increases it brings, has generated increased financial stability.
- This stability, with the increased availability of finance, is now funding both refurbishment and development programmes.
- The financial position of Housing Associations remains secure with increasing operating surpluses.
- The underlying increasing cost of domestic energy is driving considerable investment in carbon reduction, increasing energy efficiency and reducing fuel poverty in the sector.
- Changes to welfare reform, although in train to some degree, have not yet been fully implemented but together with the high demand for affordable accommodation are providing new opportunities to broaden our service into housing management provision and related partnership models.

### Funding sources

The total revenue spending resources for Social Housing in England was £24.8 billion in 2014, having increased from £21 billion in 2010, heading to an estimated £28 billion by 2017. Ongoing prudent financial management, income increases above inflation, asset appreciation above inflation and increasing investment facilities will continue to support the industry's further growth and development.

Similar patterns, on a proportionate scale, are expected in Scotland and Wales.

**Resources for investment in services and new and existing assets come from four sources:**

1. Although varying across the sector, generally 80% of funding for repairs and maintenance expenditure comes from collected rent. The basis for annual rent increases from April this year will change to CPI plus 1%. The other funding sources are capital receipts from sales, both voluntary and those required by statute; service charges for services not covered by rent; and new capital secured through traditional loans, the issuing of bonds and more recently new financial instruments including institutional investments such as public sector pension funds.

2. Most Housing Associations, and an increasing number of Local Authorities, build new housing, which increases stock volume and turnover. Developing Housing Associations receive a grant contribution from the Government, together with some Local Authorities, to support new housing; although the arrangements for this grant funding have changed it still supports significant numbers of new homes. The current programme is for 165,000 new affordable homes in England by 2018, 30,000 in Scotland by 2016 and 7,500 in Wales by the same date.

3. Over the period 2010 to 2015, the total number of homes owned and managed by Social Housing providers across all tenures will have increased by approximately 100,000.

4. Over the period 2010 to 2017, the combination of above inflation increases in income and below inflation increases in costs will drive an increasing year-on-year surplus amongst Housing Associations which hold over 60% of Social Homes. The operating surplus is forecast to have increased from £2,242m in 2010 to £5,159m in 2017. These surpluses are being used principally to offset the cost of new development work for which central grants have been reduced.

## Housing management

### Strong change drivers

- Financial incentives to maximise asset values and income streams.
- Housing waiting list pressures on existing stock.
- Private rental demands increasing in addition to social housing.
- House building bringing in new financial and management models.
- Welfare reform still at first stage impact.
- Increasing regulatory pressure to deliver value for money.

### Mears strategy

- Developing preferred partner arrangements with existing customers.
- Build upon the acquisition of Omega Housing to develop further housing management opportunities.
- Superior service delivery ethos.
- Strong capability synergy between our maintenance, housing management, new homes and energy offering.

**Total revenue spending resources for Social Housing in England**

**£24.8 billion**

## Our future growth

The pipeline of repairs, maintenance, improvement and refurbishment opportunities will continue to remain strong given the increasing financial strength of almost all Social Landlords.

The reduction in Government grants for new homes coupled with increasingly high demand, the impact of welfare reform and the need to demonstrate value for money is pushing clients to reconsider best value approaches to housing management and the provision of new homes.

Housing management is a £4 billion service that is almost entirely insourced. Through the acquisitions of Plexus and Omega Housing and the continued development of our Mears 24/7 call centre we have made real progress in broadening our response to changing requirements.

Our clients in pursuit of sustainable homes and tenancies are keen to reduce the energy their homes consume. Together with the Energy Company Obligation (ECO) scheme, which is providing new funding into Social Housing, Mears is helping clients to both access the funding, delivering the works required and bringing efficiencies to the tenants.

Our broader business base, incorporating our new homes capability alongside management and maintenance, supports our involvement in new partnering models as they emerge alongside traditional outsourcing contracts. This presents new opportunities for Landlords to work with Mears and thereby enable us to access work that would previously have been done exclusively in house or not at all.

# Our markets continued

We continue to place great emphasis on winning high quality contracts that provide clear and sustainable margins with good cash flow dynamics.

## Community-based care

### Change drivers

**Demographic factors**

- The number of people over pensionable age is expected to grow by over 4m by 2037.
- Over the same period the number of people:
  - aged 80 and above is projected to more than double by mid-2037;
  - aged 90 and above is projected to more than triple; and
  - who are centenarians is projected to rise from 13,000 in mid-2012 to 111,000 in mid-2037, a more than eightfold increase.
- This increase in the numbers of older people means that by mid-2037 one in twelve of the population is projected to be aged 80 and over.*

**Supply-side**

- Greater involvement and funding from the NHS.
- Increasing consumer and regulatory pressures fuel demands to improve quality, which continue to drive consolidation.
- Shift in commissioning practices to secure outcomes supports providers who can drive long-term quality improvements.

**Economic**

- The drive to reduce pressures on public spending demands Local Authorities to work with the NHS to integrate care-related services.
- The NHS and Local Authorities will spend £5.3 billion for service integration in 2015/16.**
- Increasing amount of complex care, an increasing proportion of which is for people of working age, including hospital discharge and end-of-life care, which are developing into new service areas.
- Movement of national policy, covered by legislation, to cap the maximum amount a person has to pay for their care from 2016, which is likely to result in a significantly increased number of people receiving funding towards their care.

### Funding sources

The main source of funds for care in England, Scotland and Wales is Local Authorities: County Councils and all single tier authorities – London Boroughs and metropolitan and unitary authorities – in England and unitary authorities in Scotland and Wales.

In England total spend on domiciliary and day care for older people and those of working age amounts to £7.9 billion per year.*** The equivalent figures for Scotland and in Wales are £600m and £400m respectively. The Northern Ireland arrangements are through Health and Social Care Trusts with spending of £175m on day and domiciliary care.

In addition to this collective purchasing by public bodies, private individuals, who purchase their care direct without recourse to public funds, add an annual spend of a further £1 billion. This is being supported by the state sector by the continued introduction of personal budgets which now support 8% of current care service users.

In addition, the NHS is increasingly involved in the commissioning of and on occasions directly financing Social Care as the drive for integrated services increases. Local Authorities get the bulk of their funding from Government with around a quarter coming from locally raised council tax as well as directly charged fees.

The closer working in England between Local Authorities and the NHS means investment in Social Care by the latter will increase over the period of the next Parliament.

We expect annual market growth in care related spend of up to 10% from 2016 to 2020. This will impact, in particular, around more support for complex community-based services, to help reduce the enormous growth in the pressures upon NHS Accident and Emergency facilities and subsequent diagnosis and treatment.

* Office for National Statistics November 2013.

** Autumn Statement December 2014.

*** HSCIC December 2014.

## Care commissioning trends

While the pace of change is slower than we would like, there is momentum created by innovators such as in Wiltshire and Torbay.

### From...

- Paying for tasks done by the minute.
- Frameworks with a large number of principal providers.
- Single service tenders.
- One to three-year tender periods.
- None or little thought to workforce support or outcomes for service users.
- Institutional commissioning.

### To...

- Commissioning for outcomes for service users.
- Strategic partnerships.
- Multi-service requirements.
- Four to eight-year tender periods.
- Greater emphasis on workforce development.
- Integration of Care and nursing-led services.

## Our future growth

### Care transformation

We are continuing to see the emergence of new commissioning models that are long-term partnering orientated, focused on improving quality and cost over time and combining services, including health, care and even housing, into an integrated approach while seeking to achieve better outcomes for users at less overall cost to the public purse.

In many ways these are reflective of the way many of our Social Housing contracts are commissioned in that they are bringing a more strategic approach which at the same time puts the service user as the focal point for achievements.

Irrespective of the political composition of the next Government we see policy supporting more thoughtful, joined up health, care and housing services.

### Opportunities in more complex care services

As part of this move to integrate services at a local level we are seeing increasing opportunities to deliver more complex services in people's homes.

This is the case when there is an integrated approach to commissioning involving the Local Authority and the NHS. Our Mears Nurseplus service, a 2013 acquisition, provides us with the skills and expertise to bid for services where the involvement of nursing staff is required.

We have added to our first Continuing Healthcare work in England, which we secured last year, and we expect this to be a significant source of growth over the next five years.

# Our strategic goals

Our strategy is to be market leader in transforming Social Housing and Care environments.

## Our values

**We value our customers and communities,** putting the needs of our customers at the heart of everything we do.

**We value personal responsibility,** setting and achieving consistently high standards in our work and conduct, and not adopting a negative attitude.

**We value teamwork,** supporting each other, sharing ideas and never excluding others.

**We value innovation,** being inventive in our approach and never allowing conventional thinking or bureaucracy to get in the way.

Read more about our key performance indicators on **pages 14 to 15**

Read about our risk management and principal risks on **pages 22 to 25**

## Our strategic priorities are:

### 1 Deepen our client partnerships in both core markets

**We believe there remains significant opportunity to continue to deliver strong growth in both our core markets of Social Housing and Care in the Home. As our clients' needs have changed, they have increasingly encouraged and supported us to develop a broader service offering around these two core areas.**

As one example, the impact of the welfare reforms and the need to provide more Social Homes is making clients reconsider best value approaches to housing management. Housing management is a £4 billion opportunity which is currently almost entirely in-sourced. In October 2014, we completed the acquisition of the Omega Group, a leading private sector provider of accommodation and management services to the Social Housing market. This acquisition enhances our ability to work more widely with housing providers to improve the delivery of housing and asset management services and to increase the supply and management of housing, in line with our strategy to grow and evolve our Housing management offering. We will continue to bring in and develop new senior management who are recognised as experts in these emerging fields.

We are increasingly recognised by clients as an organisation that can not only effectively maintain properties but also partner with them in the development of their overall asset management strategy. In 2014, this has included helping them find and indeed build on land that otherwise would not have been fully utilised. We see increasing opportunities here for 2015.

Secondly, the acquisition of ILS in 2013 increased the level of work in higher acuity services. During 2014 we have further increased our capability to deliver more complex care with the recruitment of ten new technical case managers, which we are confident will underpin strong growth in 2015. Case managers work directly with hospitals and enable people with often very complex conditions to be safely discharged and looked after in their own homes. We are seeing increasing opportunities from the NHS around more complex services being delivered in people's homes, given the rising and well publicised pressures on hospitals.

We now have the opportunity to bid for services where the involvement of nursing staff is required. We were particularly pleased in 2014 to be awarded the first single provider partnering contract for care and support services in the UK, with the Torbay and Southern Devon Health and Care Trust. This contract will begin in April 2015 and will be an important reference site for further contracts of this type.

KPIs

Social Housing new contract success rate
Order book growth
Revenue secured
Revenue growth

## 2 Maintaining quality leadership

**The success of Mears is intrinsically linked to maintaining quality leadership in both our markets. For us, quality is a factor not only of direct customer satisfaction but also of the broader contribution we make to the markets we serve. Service quality remains our key differentiator and yields our competitive advantage. All our services are designed around the direct input of tenants and service users.**

During 2014, 91% of our customers rated our services as excellent. We operate an innovative national Change Club, which involves a network of hundreds of tenants from across the UK who have met and communicated with us on a regular basis throughout 2014. Their role is to help guide and develop our service improvements. We are particularly pleased to have seen the service improvement achieved on many of the acquired Morrison contracts in 2014. Once again, 2014 also saw Mears undertake hundreds of local community projects, with our staff and our supply partners often volunteering their time and resources for the benefit of local communities.

For our care and support business, we pay particular attention to our regulatory compliance levels, which have improved throughout 2014 and now benchmark very strongly against our major competition.

KPIs

Percentage of people rating our service as excellent

Number of customer complaints Jobs completed within time

## 3 Developing our people

**For us this essentially means three things. First that we have the right structure and leadership team to achieve our ambitions. 2014 saw our biggest investment in training for the future leadership team since Mears first began. This investment will be increased in 2015 to reach middle and lower management levels.**

Second, that we deliver on our responsibilities to recruit and develop local people from the communities in which we work. We were extremely proud in 2014 to be awarded Social Mobility Champion status by the Office of the Deputy Prime Minister for our work in helping people from disadvantaged backgrounds to develop skills and careers. We are one of only twelve UK companies to have achieved this status. We are also one of the top 100 employers of apprentices. We will further develop this area in 2015 for the benefit of clients and their tenants.

Third, and critically, we have championed the need to improve the terms and conditions of care workers. This is vital to have the high quality and sustainable workforce that is needed to cope with the rapidly increasing demand for services. We supported the work of the Burstow Commission, an All Parliamentary Group, which has set out clear recommendations for how the system needs to improve. We have also invested heavily in the terms and conditions of our own Care workforce in 2014 and will continue this in 2015.

KPIs

Number of apprenticeships and job experience opportunities

Output from employee surveys

Output from reward and recognition benchmarking

Read more about our case studies in the Operational Review on **pages 26 to 33**

# Key performance indicators

Our KPIs are our most important measures of success. They are divided between service delivery measures, contract bidding measures and financial outputs.

## Service delivery

**Key measure and description** | **How we performed** | **Results from the year**

### 1 Percentage of people rating our service as excellent

2014 target >83% — Out performance

Unlike the industry, which uses 'satisfactory', we measure the percentage of people who rate our service as 'excellent' and work hard to maintain our service leader status. We conduct around 80,000 surveys per year via phone and directly with the customer via our operatives' handheld devices.

We are delighted to have seen further service improvement. It is pleasing that the acquired Morrison contracts are all now performing strongly.

| | |
|---|---|
| 2014 | 91% |
| 2013 | 82% |
| 2012 | 80% |

2015 target >90%

### 2 Number of customer complaints

2014 target <0.28% — On track

Whilst we achieve high levels of service excellence, it is important that we monitor carefully the number of poor service incidents, that we deal effectively with each individual complaint and that we learn from underlying trends.

Following the acquisition of Morrison, our customer performance metrics inevitably showed a slight worsening. However, the acquisition is now fully integrated and bedded down and it is pleasing to see the performance of the enlarged Group now returning to its historical level.

| | |
|---|---|
| 2014 | 0.30% |
| 2013 | 0.31% |
| 2012 | 0.29% |

2015 target <0.30%

### 3 Jobs completed within time

2014 target >92% — On track

Delivering on our promises is at the heart of Mears. Each of our contracts has specific targets around job completion time based on the nature of the work. Emergency jobs are typically undertaken same day while routine work will be scheduled. Having agreed the standards by type of work, it is obviously important that we stick to them.

To maintain this performance measure at a consistently high level is a positive outcome for the year. We continue to focus upon training and development of our staff and we continue to invest in our business systems to maintain this performance level.

| | |
|---|---|
| 2014 | 91% |
| 2013 | 92% |
| 2012 | 92% |

2015 target >92%

## Contract bidding

**Key measure and description** | **How we performed** | **Results from the year**

### 4 Social Housing new contract success rate

2014 target >33% — Out performance

We typically tender £1–2 billion of new opportunities each year. The average contract length is around six years in length. In order to achieve our organic growth forecasts, we monitor the proportion of new contracts secured as a proportion of total tendered works.

The opportunities available to the Group over the longer term remain at historical levels. The Social Housing order intake was impacted temporarily from a quieter period of new bidding opportunities, our conversion of new bidding opportunities reported an increase to 35%. This is an important metric, one that will serve us well once the bid pipeline picks up.

| | |
|---|---|
| 2014 | 35% |
| 2013 | 32% |
| 2012 | 32% |

2015 target >33%

### 5 Order book growth

2014 target +10% — Under performance

We typically secure long-term contracts with our clients. Our Social Housing contracts average six years in duration and our Care contracts are typically shorter at around three years. We only place a value against orders which are contractually secure and where the delivery of the works is highly probable.

Our order book has been negatively impacted by a lower level of opportunities to bid in year. However, in the short term it is the revenue visibility metric that is of primary importance. In the medium to long term, the order book has increasing importance. We are confident that the bidding opportunities available to the Group over the longer term remain at historical levels.

| | |
|---|---|
| 2014 | -13% |
| 2013 | 2% |
| 2012 | 31% |

2015 target +10%

### 6 Revenue secured

2014 target 95% — Under performance

The majority of our new contract opportunities follow the strict Government procurement process. The average tender will take around twelve months from initially being advertised to the successful party being formally awarded the work. In addition, the average contract takes 13 weeks from award to contract commencement. Therefore whilst we have good visibility of opportunities, the process for converting opportunities into secured revenue is slow. We therefore require a high level of visibility for the coming year as much of our bidding activity will now be for the benefit of 2016 rather than 2015.

Whilst 92% visibility is excellent, the time period for bidding, securing and mobilising new work is slow and therefore we would ideally like to have 95% visibility at the start of a new year. This shortfall to target represents an added challenge to the Group if it is to hit its 2015 forecast.

| | |
|---|---|
| 2014 | 92% |
| 2013 | 92% |
| 2012 | 88% |

2015 target 95%

# Financial outputs

| Key measure and description | How we performed | Results from the year |
|---|---|---|

## 7 Revenue growth

### Social Housing

2014 target +6% — Under performance

Revenue represents the amounts due for services provided during the year. In order to measure organic growth, we deduct revenue derived from assets that have been acquired. We believe that organic growth gives a better indication of business performance, as it is a purer aggregation of market growth, success in new contract bidding and contract retention.

We expected some reduction in Social Housing revenues given the normalisation of the Morrison run-rate; however, the absence of any material new contract mobilisations resulted in a quieter period than we anticipated. We significantly enhanced our future growth prospects through the development of our Housing Management business, both through the acquisition of Omega and through organic investment in people and systems.

| Year | Result |
|---|---|
| 2014 | -4% |
| 2014 | +10% |
| 2012 | +19% |

2015 target **+6%**

### Care

2014 target +2% — Under performance

Revenue represents the amounts due for goods and services provided during the year. Our strategy in Care is to grow our existing business organically whilst making further strategic acquisitions to increase the services that we can offer to our clients.

The Care division reported revenue growth of 1%. This growth includes a full-year impact from ILS, acquired in April 2013, without which the underlying business would have reported a reduction in revenues. The reduction of revenues, taken in isolation, is disappointing. However, significant progress has been made in developing both the business and the wider market. The major hindrance to growth in Care remains our ability to source sufficient Care workers of good quality; the challenge will only increase as we move forward and it is essential that we find solutions to address this.

| Year | Result |
|---|---|
| 2014 | +1% |
| 2013 | +9% |
| 2012 | +4% |

2015 target **+9%**

## 8 Operating margin

### Social Housing

2014 target 4.6% — Out performance

Social Housing operating margin gives a strong indication of profitability. We continually monitor our operating margin and manage our cost base to ensure that our services are delivered efficiently.

We are delighted to see an increase in the operating margin, driven primarily by the improving contract margins being generated from the ex-Morrison business. We are delighted that within two years of completing the Morrison transaction, we have a portfolio of financially sound contracts; our customer service has underpinned this turnaround. The margin is further assisted by a reduced number of new contract start-ups, which are typically loss making in their initial mobilisation period.

| Year | Result |
|---|---|
| 2014 | 4.8% |
| 2013 | 4.5% |
| 2012 | 4.7% |

2015 target **5.1%**

### Care

2014 target 7.8% — On track

The Care operating margin gives a strong indication of profitability. We continually monitor our operating margin and manage our cost base to ensure that our services are delivered efficiently.

We are pleased that the operating margin at 7.8% has been maintained at the levels achieved in the prior year, despite our significant investment in improving the terms and conditions of our workforce. We are committed to improving the terms and conditions of our carers; notably our aspiration to increase pay rates towards the living wage and a movement away from zero-hour contracts. We still have a long way to go to achieve this and we require the commissioners of care to share this ambition.

| Year | Result |
|---|---|
| 2014 | 7.8% |
| 2013 | 7.8% |
| 2012 | 8.3% |

2015 target **7.8%**

## 9 Profit to cash conversion

2014 target >75% — Out performance

The efficiency with which the Group manages working capital remains a cornerstone of our business. The key measure is cash inflow from operating activities as a proportion of EBITDA. Whilst we internally target 100%, our external target allows some leniency reflecting an increased working capital requirement to fund organic growth.

This is an excellent outcome. We have developed a cash culture within the Group where the importance of managing our working capital is well understood. Our business systems are developed to support this area.

| Year | Result |
|---|---|
| 2014 | 96% |
| 2013 | 103% |
| 2012 | 108% |

2015 target **>75%**

## 10 Normalised diluted EPS

2014 target >10% — Out performance

Normalised earnings are stated before exceptional costs and exclude the amortisation of acquisition intangibles together with an adjustment to reflect a full tax charge.

We are pleased with this strong performance. The turnaround at Morrison has underpinned this strong earnings growth. We continue to invest in both operational and financial management and focus on sustainable contract opportunities.

| Year | Result |
|---|---|
| 2014 | 15.0% |
| 2013 | 10.0% |
| 2012 | 6.7% |

2015 target **>7%**

# Our people

A major factor behind Mears' success is the commitment to the training and development of our employees.

## Mears champions social mobility

The Government has recognised Mears alongside eleven other of the UK's most high profile companies for leading the way in ensuring disadvantaged young people have a better chance of getting on the jobs ladder.

As a Champion, Mears is driving a new benchmark for social mobility by committing to meet a set of strict criteria over the next twelve months, building on existing work, including:

- developing relationships with schools and young people;
- targeting efforts on institutions with above-average levels of disadvantage;
- widening the geographical spread of opportunities; and
- offering well structured non-graduate entry routes and driving forward recruitment practices that eliminate barriers to social mobility.

The **deputy prime minister, Nick Clegg**, launched the Social Mobility Business Compact Champion Tier. He said:

"Businesses know they need to find the best talent in order to succeed. This means searching beyond the usual recruitment methods and hiring young people with great potential, whatever their background. It's great to see leaders in industry backing this approach. However many businesses are still missing out, and more companies need to follow in the footsteps of the Champions we have announced today if we are to achieve our aim of a stronger economy and fairer society."

## Valuing diversity and creating opportunity

Mears has a diverse workforce of over 13,000 staff and almost 400 apprentices; the vast majority live in the areas that they work. Indeed we are now one of the top 100 employers of apprentices in the UK.

Diversity and respect for all are core to our induction programme and our training on recruitment and customer care.

## Future leaders

This year saw Mears make its biggest commitment yet to training and developing employees at all levels in the Group from new recruits through to our most talented and experienced people.

In 2014 we ran pilot management development programmes at three levels. Our Senior Leadership programme catered for those with the potential to become future senior leaders and Directors at Group and operating company levels. Our Housing Branch Manager and Supervisor programmes focused on the enhancing and strengthening of skills in order to improve performance, as well as stretching delegates who have the potential to take on more senior roles in the future.

The overwhelmingly positive response from delegates and their line managers means that in 2015 we will expand our offering to six programmes. As well as new Housing Branch Manager and Supervisor cohorts, we will replicate the same for the Care business. We will also run a Mixed Manager programme for those who work outside of core operational Housing and Care roles.

## High standards from the start

Revitalising the induction process for new employees aims to increase the speed and efficiency with which new employees become job ready, as well as to make sure they get the best possible first impression of Mears.

We have improved our processes and increased our efficiencies in capturing the training and development activities of the Group. We have increased the accessibility of employee training data for line managers, enhancing our defensibility in terms of ensuring legally required training has been completed and maintained by the right people at the right time.

Our Welwyn Garden City technical training centre has continued to increase the number of hours of training delivered. The centre provides upskilling across a wide range of trade disciplines in a cost-effective way. Having reached over 200 people in 2013, this rose to over 250 during 2014.

On the Care side of our business, training is designed not only to meet the needs of our service users and the requirements of the regulators, but also to promote industry best practice in mandatory subjects such as manual handing, safeguarding adults against abuse and support with medicines management. This training is supplemented with a series of more specialised training workshops that provide our staff with insight into the specific needs of service user groups including training on supporting people with dementia, learning disabilities and epilepsy.

Training courses are continually reviewed to ensure that they are in line with Skills for Care standards and changes in legislation. Our approach means that we are well placed for the implementation of the Care Certificate in 2015. The provision of good quality training is essential if we are to remain a high quality provider of personalised, effective and responsive care services.

## Engaged employees

During 2014 we have continued to develop initiatives to help all Mears employees gain a broad understanding of the business they work for and to ensure that every individual feels valued for the role they perform and empowered to contribute to organisational decisions.

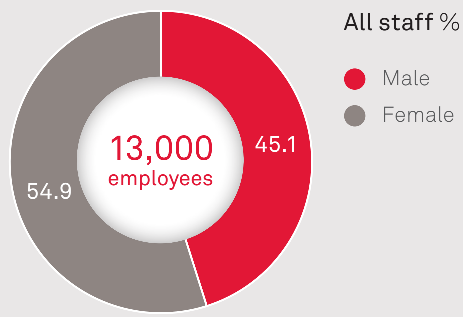
Delivering integrated multi-directional communications and engaging with our thousands of care workers and housing operatives means that managers need information, support and tools which enable them to improve engagement locally and foster a team spirit. Branch managers now participate in face-to-face briefing sessions with the Executive Team. The CEO's weekly senior management briefing keeps senior managers informed of current issues and news. Items of general interest goes out as a daily Mears Matters email to around 4,000 staff every morning with branches asked to pass on relevant items to field staff.

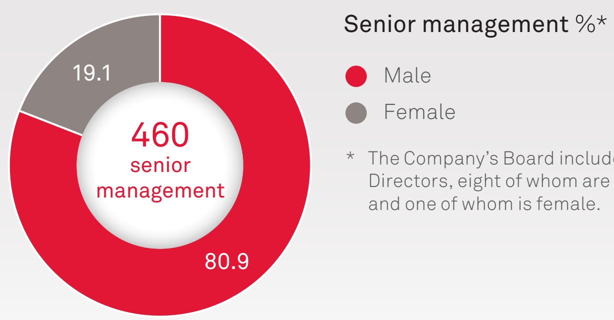
In the summer we ran a highly successful range of communication meetings around the country. These combined regional cross-business networking sessions that identified common issues with an informal 'social' event for all staff with a health and wellbeing theme that offered free health checks.

We hold two family fun days, one in Scotland and one in England. These free events are designed to say thank you not only to our employees but also to their families. Over 9,000 people attended in 2014 across the two events at Drayton Manor and Blair Drummond Safari Park. Feedback for these events is always enormously positive with many staff proactively writing to thank the Group for the day and praising the event organisation.

Our Mears Advantage discount scheme enables our staff to save money on their weekly shop, while Mears Assist enables staff to get free and independent advice on a range of work and non-work related topics.

## Workforce makeup




* The Company's Board includes nine Directors, eight of whom are male and one of whom is female.

## Celebrating performance

Individual or team success, good news stories and best practice initiatives are shared with all staff through the quarterly staff magazine and the increasing number of branch newsletters that combine local news with Group news.

Mears Smile awards are increasingly popular with an increase in nominations. All nominees are given a 'you've been nominated' card by their manager and go through to the quarterly regional finals. Many branches are extending the programme locally with a Branch Smile award and putting nominations together with compliments onto a dedicated display board.

In 2014 we launched the Reg Pomphrett Apprenticeship and Learner Award to acknowledge and reward the achievements of our young employees. An overall Apprentice of the Year and Mears Young Learner of the Year were chosen from the outstanding candidates nominated by the Housing and Care businesses. As part of the selection process the top ten candidates participated in a reservists' outward bound programme in Shrewsbury and won the Best Team award.

# Corporate responsibility

Good customer service is more than delivering an effective repairs and care service. We see it as our responsibility to make a long-term difference to the sustainability of the communities in which we operate.

## Mears' sustainability strategy has five guiding principles:

1 **Long-term customer relationships**

We focus on long-term customer relationships with shared goals and trusted relationships. We recognise that, for our customers, we have a responsibility beyond just repairing a home or delivering a good standard of personal care.

2 **Excellent employee experience**

We believe we will not give a great customer experience if the employee experience falls short of this.

3 **Responsibility for the environment**

We have worked in local communities for many years and as such we have a huge responsibility to the environment in which we operate.

4 **Responsible leaders**

Our customers, staff and investors have a right to expect responsible leaders and staff within Mears who operate with clearly defined standards of behaviours and fit-for-purpose governance.

5 **Diversity in our business**

We see diversity as a strength.

Read more about our diversity policy on **pages 16 to 17**

## Keeping communities safe

The Safer Homes project is a free service provided by Mears in partnership with North Lanarkshire Council. This multi-agency initiative involving the police, the fire brigade, Woman's Aid and Age UK has had over 1,200 referrals from agencies since its launch in October 2012.

The service is offered to householders who could benefit from additional safety and security measures such as door chains, carbon monoxide detectors, window and door alarms, home safety packs and spy holes. Mears Safer Homes is an innovative project designed to aid the local community by carrying out a package of home safety and security installations to reduce the occurrence of crime and the fear of crime and unintentional injuries in and around the home. Mears Safer Homes is currently completing around 30 installations a week.

Delivering this worthwhile service allows Mears to highlight the dangers of bogus callers and provides tenants with information and tools to help them keep safe in their homes. Mears provides a dedicated tradesman and apprentice to carry out home safety and security installations as well as an administrator to provide a point of contact for all referrals from the agreed practitioners' groups. Mears also works closely with the community police and regularly attends service user events and action days to promote this worthwhile service.

## Valuing customers

We continue to prioritise customer service and for the third year in a row our Housing business has been awarded the Government's highly coveted Customer Service Excellence award.

Mears was the first repairs and maintenance contractor of its size to achieve this standard, which was set up to encourage the public, private and voluntary sectors to put customers at the heart of service provision. Since achieving the standard across our housing operations, four Care branches – Burton-on-Trent, Rotherham, Wallsend and Wirral – have undertaken the assessment process and all have achieved accreditation. The process looked at every aspect of the business including 'front line' visits where the assessor interviewed care workers and the service users about their care. The assessment awarded 'Compliance Plus' scores in several areas, including the professionalism of the branch management teams; our Smile Award scheme; our STAR campaign, which created medication reminder cards; and our approach of working in partnership with clients.

The assessor said she was 'bowled over' by how genuinely caring all the staff are and that she had been particularly impressed by the front line staff's insight and personal approach to each individual they cared for.

## Supporting communities

Mears has always believed that good customer service is more than just ensuring that we deliver an effective repairs and care service. Given the longevity of most of our contracts, we see it as our responsibility to make a long-term difference to the sustainability of the communities in which we operate. In 2014, once again, over 600 local community projects were carried out by our staff. From North Lanarkshire to Falmouth and many places in between, our employees undertook a host of voluntary activities that included repainting nursery school playgrounds; creating patio and garden areas for sheltered housing schemes; fund raising to improve sporting facilities; organising community fun days; and holding music mentoring classes for school pupils.

Loneliness is now known to be a bigger killer than smoking. The Mears Foundation, the independent, charitable arm of Mears Group which has been set up to harness the goodwill, talents and skills within Mears, has created a fund to support grassroots activities which are tackling loneliness. Thousands of pounds have been raised due to the efforts of Mears employees, including an auction of promises which featured prizes donated by 40 members of our leadership team; a virtual bike ride which saw Mears staff peddling hundreds of miles without leaving the office; and our 'Pennies from Heaven' initiative which asks staff to donate the pennies from their monthly pay cheque. Funds are targeted to those projects that are enabling isolated people to establish social networks.

# Corporate responsibility continued

Providing employees with a safe working environment remains paramount, which is why our accident rates continue to reduce year on year.

## Mears Interhub

**Mears has made a commitment to help address the loneliness experienced by so many people.**

Mears has joined forces with Gateshead College, Newcastle United FC Foundation, Sunderland FC Foundation of Light, Age UK and Autism in Mind to set up a community interest company in Gateshead. The Interhub is designed to be a dynamic centre that focuses on finding solutions for some of the most persistent social problems such as social isolation and long-term unemployment. The Interhub will provide accessible, high quality, sustainable services for people living in the north east.

The Interhub will offer inclusive intergenerational activities and deliver a modular programme tailored to an individual's specific circumstances. Up to 30 clients a year will learn essential skills such as how to write a CV and how to prepare for an interview. Training and support will be given on appropriate job searches and individuals will be given work experience to help them gain confidence and become work-ready.

### Responsible business leaders

We are extremely proud of our health and safety performance and it remains a priority for the Mears Board to review performance at every Board meeting. Providing our employees with a safe working environment remains paramount, which is why our accident rates continue to reduce year on year. In 2014, we reduced our accident frequency rates by 10% through proactive campaigns, training and site inspections.

The year 2014 not only proved to be a safer year but we also trained more operatives and managers. New initiatives were introduced including our STAR moving and handling campaign which encourages staff to stop, think, act and review. We are particularly pleased to have retained our Royal Society for the Prevention of Accidents (RoSPA) Award, making this Mears' twelfth consecutive Gold Award.

### Championing positive change for customers and staff

Mears provides a range of services that help address some of the major challenges faced by British policy makers. Our thought leader programme brings sector leaders together to design, create, discuss and roll out best practice in the Social Housing and Social Care sectors. Our expertise means we are well placed to support and influence policy makers both at a national and a local level.

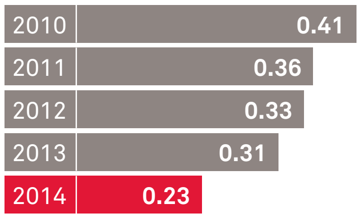
Throughout 2014 we have continued to work with the Department of Health and Local Authorities around the introduction of outcome-based commissioning models and we are delighted to see a number of Local Authorities moving away from a task-and-time approach. We have also focused on what can be done to improve the status of the care workforce, initiating and funding the Commission on the Future of the Homecare workforce, which was chaired by the Rt Hon Paul Burstow, MP. Valuing our care workforce, offering guaranteed hours and providing opportunities for progression are key for workforce retention and to drive up the standards of care provision.

We have continued to speak out on issues such as fuel poverty, combining our front line practical interventions, which are helping people lower their fuel bills and increase energy efficiency, with top-down influencing in order to challenge measures which act as a barrier to the elimination of fuel poverty. Mears continues to support the work of the Energy Bill Revolution, an alliance of organisations including charities, environmental groups, trade unions and businesses that are committed to ensuring warm homes and lower bills.

We are developing our thinking around homelessness and tackling the barriers which are deterring Local Authorities from building the next generation of Social Homes.

**Accident frequency rate** (%)

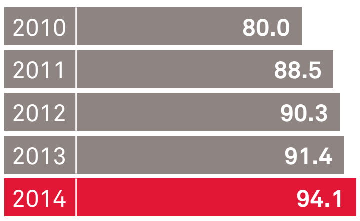
# 0.23




Providing our employees with a safe working environment remains paramount. Our accident rates have reduced year on year.

**Waste diverted from landfill** (%)

# 94.1




We work hard to minimise the negative impact of our operations on the environment. Our recycling rates have continued to improve.

## Protecting the environment

In 2014 we have improved the level of waste diverted from landfill from 91% to 94%.

Mears recognises the importance of measuring and addressing its own carbon footprint, which is why it operates an environmental policy accredited with ISO 14001. We work hard to minimise the negative impact of our operations on the environment.

Mears continues to operate a local employment strategy with approximately 90% of its workforce living within the postcode district of their branch, meaning staff spend less time on the roads getting to work. For staff who require a vehicle to carry out their roles, training in economical driving has been shown to reduce fuel consumption by up to 20%. Each of approximately 100 housing branch offices throughout the UK has an Eco Champion, who is instrumental in the promotion and exchange of information on good practice and is supported with regular information, briefings and advice to develop green initiatives locally.

Mears' commitment to the environment extends beyond its own operations into the supply chain. Approximately 85% of our £70m annual spend is on materials directly purchased with merchants recognised for sustainable procurement. Mears buys 100% FSC approved timber from its preferred suppliers.

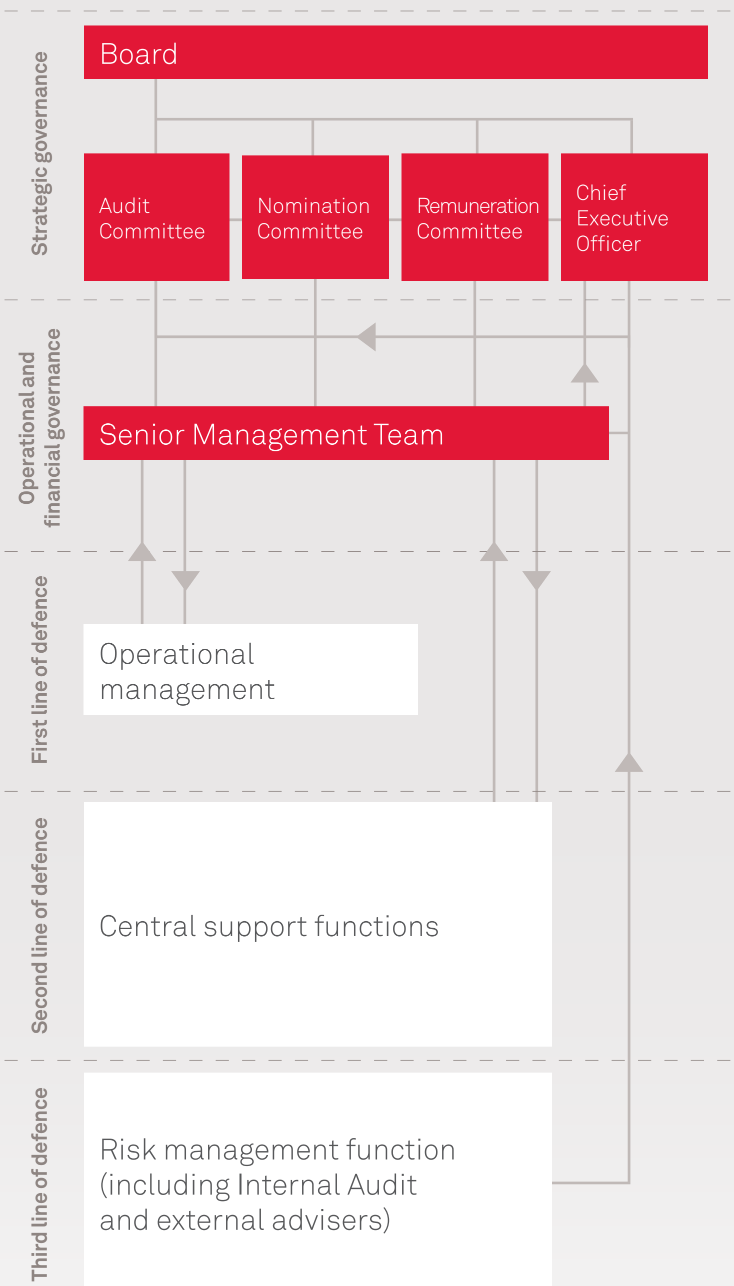
Mears continues to reduce carbon emissions as detailed below.

| | Units | **2014** | 2013 |
|---|---|---|---|
| Scope 1 | Tonnes $CO_2e$ | **21,039** | 16,787 |
| Scope 2 | Tonnes $CO_2e$ | **1,467** | 1,715 |
| Scope 1 and Scope 2 intensity | Tonnes $CO_2e$/ £m Revenue | **26.83** | 21.38 |

# Risk management and principal risks

The effective management of risks is a key feature in the continuing success of Mears. We have a clear framework for identifying and prioritising our risks together with a robust mitigation process to reduce their impact.

## Risk management process




### The Board

The Board has ultimate responsibility for the effectiveness of the systems and processes of risk management and internal control.

### The Audit Committee

The Audit Committee is responsible for assisting the Board in discharging its responsibilities. The Audit Committee reports to the Board on its activities and makes recommendations and escalates significant risks or matters to the Board as appropriate.

### The Senior Management Team

The Senior Management Team reviews and identifies the key risks which may impact upon the achievement of the Group's strategic goals and will consider how these risks are developing with changes in the operations, markets and the regulatory environment.

The nature of the risk is reviewed including the possible triggering events and the aggregated impacts before setting appropriate mitigation strategies directed at the causes and consequences of each risk. The risk is assessed in relation to the likelihood of occurrence and the potential impact of the risk upon the business and assessed against a matrix scoring system which is then used to escalate risks within the Group as appropriate. The Senior Management Team has responsibility for managing the Group's key risks.

### Risk management function

The Group Risk Function supports the risk management process by providing guidance, support and challenge to management whilst acting as the central point for coordinating, monitoring and reporting on risk across the Group. To ensure our risk management process continues to drive improvement, the Group Risk Function monitors the ongoing status and progress of mitigation plans on a quarterly basis.

The Group outsources elements of Internal Audit to external advisers.

The control environment is underpinned by a detailed scheme of delegated responsibilities that defines processes and procedures for the approval process in respect of decision making. This ensures that decisions within the organisation are made by the appropriate level of management.

Details of financial risk management and exposure to price risk are given in note 20 on **pages 105 to 110**

Read more about governance measures on **pages 38 to 44**

Read more about the Audit Committee on **pages 46 to 49**

## Risk management

We **have endeavoured to simplify the reporting of our key risks** to ensure that shareholders understand those principal risks which we see as business critical or potentially catastrophic.

We have described in detail how we seek to manage and mitigate those risks. We have also linked these risks to other areas of our Strategic Report: our business model, our markets and our strategic objectives.

For completeness, we have also provided a list of other risks. These other risks continue to be closely monitored and managed as the Board considers appropriate. These other risks may be significant at a divisional or subsidiary level but are not considered sufficiently significant at Group level to warrant detailed disclosure within our Annual Report.

We consider these additional risks to be 'business as usual' and wish to avoid giving them too much focus as to do so would potentially detract from our shareholders' understanding of those principal risks which the Board believes represent the biggest challenge to the Group delivering its strategic goals.

We continue to drive improvements in our risk management process. We also review our business model, core markets and business processes to ensure that we have properly identified all risks. We continually review our mitigating actions to ensure that they are sufficient to minimise our residual risk.

## Principal risks

**Risk and description**

### Reputation

The ultimate success of Mears relies upon maintaining a positive reputation. An event, or series of events, may occur that could damage our brand in the eyes of our customers.

Poor service delivery would damage our reputation. Both our Social Housing and Care markets are close-knit communities where examples of poor performance are quickly communicated widely.

Furthermore, in Care we deliver services to people who are elderly and vulnerable. A service delivery failure within our Care division could result in the physical harm or, in the most extreme cases, death of a service user.

In the environment of caring for vulnerable people, there is a risk of isolated incidences of abuse and neglect which rightly receive significant press coverage with the inevitable reputational damage.

The ability to tender contracts with public sector organisations is fundamental to the achievement of our strategic objectives. Over recent years we have seen negative press comment attached to a number of companies involved within the arena of public sector outsourcing where past actions could negatively impact upon the ability of those organisations to tender for future work.

**Performance measures:**
Dashboard of service delivery indicators, customer excellence, complaints, jobs completed on time, void turnaround.

**How we mitigate the risks**

- In-house IT system developed to provide operational management with a real-time dashboard of service delivery indicators.
- Internal auditing of KPI reporting including 'mystery shoppers'.
- Joint venture with the Tenants & Residents Organisations of England (TAROE), which undertake independent audits.
- Strict process in place for vetting and approval of subcontractors.
- We drive a culture of putting our customers first; this is continually reinforced within internal communications.
- Well communicated policy for dealing with press enquiries and incident management.
- Care risk plans for dealing with vulnerable customers.
- Compliance management of bribery and corruption legislation and whistleblowing policy.
- We induct and train all new starters. This induction ensures that all employees understand our values and it reinforces the Group's culture.
- We ensure that staff are properly trained for their roles. We ensure that we deliver relevant training and implement best practice.

# Risk management and principal risks continued

## Principal risks continued

**Risk and description** | **How we mitigate the risks**

### People

Mears sees sound commercial management of contracts and the business as a whole as essential to achieving its objectives. The success of the Group is underpinned by the delivery of services profitably whilst exceeding our clients' expectations and our contractual obligations.

Notably in our Care division, recruitment and retention remains the biggest inhibitor to achieving our growth aspirations.

We have over 13,000 employees – the majority of these employees are interacting with our customers on a daily basis. It is this day-to-day front line contact that is fundamental in delivering a differentiated service and maximising customer satisfaction. It is therefore imperative that the Group's strategic goals are well communicated and understood by all employees.

**Performance measures:**
Employee turnover, employee training statistics, employee pay benchmarking, sickness records, grievance statistics, exit interviews.

- We induct and train all new starters. This induction ensures that all new employees understand our strategy, vision and values.
- We regularly review and benchmark our remuneration packages to ensure that they remain competitive.
- In Care, the market is highly price driven which has made it difficult to provide better rewards. Our Local Authority clients will not typically commit to any guaranteed work volume, which has made zero-hour contracts commonplace. We have canvassed the sector and Government to encourage outcome-based care contracts and associated incentives and rewards which can be shared with our frontline carers. Our pioneering Wiltshire and our new Torbay output-based contracts are hopefully indicators of a significant shift in the way that Care contracts will be commissioned moving forward.
- In Care, an increased level of resource and focus is being applied to recruitment; a more robust process in respect of handling, processing and tracking applicants is expected to increase the volume of quality carers. Local Care branches are targeted on a monthly basis in the area of recruitment and retention.
- At the senior end of the business we have increased our focus on succession planning and increased our investment in senior management development. Our Senior Leadership programme has identified a cross-section of the Group's brightest talent that we would envisage will play central roles in our future business.
- An annual appraisal process is completed for all employees to ensure that all people receive feedback in respect of their performance and to identify future training and development requirements. We hold a national accreditation as an Investor in People.
- We are continually looking to improve our position as an employer of choice by improving the level of engagement with our employees through formal communications, awards to recognise success, local events and family fun days.
- We are continually monitoring of our future skills requirements.
- We regularly undertake employee surveys to gauge employee satisfaction, engagement and any barriers to high level performance.

### Health and safety

Mears' services and operations involve a series of high risk activities ranging from dealing with vulnerable customers in need of our care, to our building related services, e.g. working at height, working with gas and electricity and dealing with asbestos.

Failure to have robust and safe systems of work could lead to serious personal injury or a fatality. In addition such a failure could lead to financial penalties and significant reputational damage.

**Performance measures:**
Accident frequency rate, reportable incidents, continuous review of insurance claims.

- We have invested significantly in single centralised HSE function to maintain consistency and quality.
- We have comprehensive safe systems of work which are well communicated through a robust and coordinated internal training regime.
- We have robust processes for inducting new staff to ensure importance of health and safety is emphasised together with detailed method statements for working safely.
- Regular HSE training and updates are held predominantly delivered by internal function.
- Significant resources have been invested to claims defensibility to ensure that invalid claims can be robustly defended.
- Internal SHE auditing takes place using third party validation.
- Annual Group SHE strategy and plan are produced.

## Additional risks

### Our markets

Pages 8 to 11 detail both our core markets, together with what we see as change drivers and the elements that underpin our future growth. Both markets are subject to Government legislation and are impacted by the political environment, local or national, including public sector policy and funding. Any changes in policy could have a detrimental effect on the Company's business.

### Integrity, ethics, anti-bribery and corruption

The Company policy is well communicated to ensure that all employees comply. This has been reinforced by training of key staff. We have a whistleblowing process to ensure comprehensive investigations are completed and robust action taken for negative findings.

### Taxation, legal and regulatory

The Group is subject to numerous tax, legal and regulatory requirements. Policies and procedures are issued and controls are in place to ensure compliance. Additional technical support is sourced as required to enhance the internal teams and to provide validation as to our compliance.

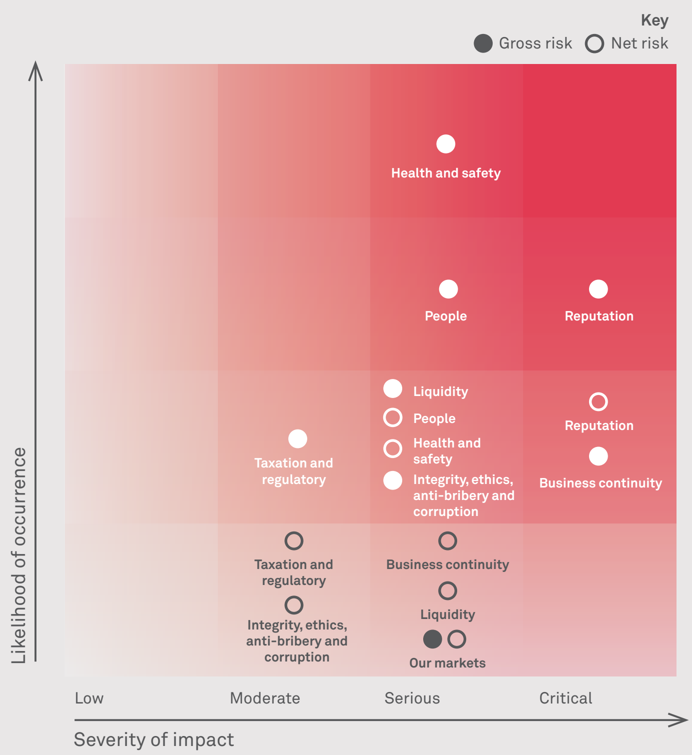
### Business continuity

We are reliant upon our information systems and technology platforms. A failure of our IT systems would have a detrimental impact to our ability to deliver our services; vulnerable people depend upon our services, hence even a short period of downtime could cause severe reputational damage. Our networks are protected with antivirus and firewall systems. A procedure for regular system back-ups is in place. A Business Continuity Plan is in place for each business unit and with particular emphasis upon our IT and Finance central support functions which would provide the greatest challenge in the event of a system failure or data loss.

### Liquidity

The Group has a revolving credit facility (RCF). The Group's cash flow forecast indicates that there is significant headroom in place to fund the Group's strategic objectives. The forecasts also indicate that the business will generate strong free cash flow to reduce the future level of debt. We expect to be able to rely on the debt market to refinance the RCF at its maturity in July 2018. The Group has entered into an interest rate swap to reduce the Group's exposure to interest rate movements. The Group transacts with the public sector, which means there is little credit risk with our customers. This area is considered further in the going concern section of the Statement of Directors' responsibilities.

## Prioritising our risks




Risks identified are documented within the Group's risk register. Risks are rated on a matrix scoring system based on their likelihood and potential severity. This severity can be measured using financial, life and limb, customer service, growth, regulatory compliance and reputational criteria. Therefore, Mears measures more than simply the financial impact of the risk. These scores are used to escalate risks and to drive the mitigation plans.

The Senior Management Team has responsibility for managing the Group's key risks. These risks are reviewed quarterly together with the mitigation activities to ensure that sufficient actions are being taken to reduce the net risk position.

# Review of operations

Service quality remains our key differentiator. We are pleased that both our operating divisions continue to achieve high standards of service delivery.

**David Miles**
Chief Executive Officer

## In summary

### Social Housing

- The Social Housing division made excellent progress in 2014. The financial turnaround of the Morrison acquisition is now substantially complete. We have broadened the services we offer across the sphere of Social Housing. In particular, the Omega acquisition has unlocked a large number of new housing management opportunities. We will look to make further acquisitions to reinforce our market-leading position.

### Care

- The award of the Torbay and Southern Devon NHS Trust contract is another crucial milestone in the evolution of the sector and for Mears' position within it. This is another significant move away from traditional 'task and time' based contracts to ones that are more outcome based. We continue to see the trend towards the joint commissioning of NHS and Local Authority services. We believe that our market-leading approach to service quality and innovation through the application of technology puts the Group in a strong position.

| | Social Housing | | Care | | Total | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m | **2014 £m** | 2013 £m |
| Revenue | **714.7** | 742.5 | **124.0** | 123.1 | **838.7** | 865.6 |
| Operating profit* | **34.4** | 33.5 | **9.6** | 9.6 | **44.1** | 43.2 |
| Operating margin* | **4.8%** | 4.5% | **7.8%** | 7.8% | **5.3%** | 5.0% |

* Before amortisation of acquisition intangibles, exceptional items and long-term incentives.

## Social Housing

The Social Housing business has delivered a solid performance with revenues of £714.7m (2013: £742.5m). As stated within our 2013 results, revenues for the ex-Morrison business initially benefited from a non-recurring spike in the period immediately following the acquisition. These former Morrison contracts delivered revenues in the year of £200m (2013: £235m) which was in line with our expectations. Moving forward, we would expect these contracts to be maintained at the current level.

We are delighted to see an increase in the operating margin to 4.8% (2013: 4.5%) driven primarily by the improving contract margins being generated from the ex-Morrison business; these margins are ahead of our original expectations. A relatively quiet period has allowed the Group to progress with margin improvement initiatives whilst there have been fewer contract start-ups, which are typically loss-making during mobilisation.

Service quality remains our key differentiator. We are pleased that our Social Housing division continues to achieve high standards of service delivery. The proportion of customers rating our service as excellent has improved to 91% (2013: 82%). Typically, others in the sector measure only satisfaction, whereas our drive has been for excellence. I am pleased that within two years of completing the Morrison transaction, we have a new portfolio of financially sound contracts with good levels of customer service.

### Social Housing – business development

The housing finance changes introduced in 2012 decentralised decision making and empowered Local Authorities to determine the future of the local housing offering they make to their communities. In addition, both Local Authorities and Housing Associations have been impacted by the introduction of welfare reforms which have changed the relationship between tenants and landlords. We communicated these changes early and, as anticipated, they had a positive effect on the funding available to Registered Social Landlords (RSLs), as evidenced by the large number that are reporting surpluses. A short-term negative, however, has been the delays in new bidding opportunities resulting from these changes.

Whereas, historically, the focus for the Housing Revenue Account was in respect of maintaining the existing stock, the additional funds available now give rise to a variety of investment decisions, causing a number of RSLs to consider their next steps over a longer timeframe. Whilst these delays have resulted in the absolute level of opportunities to bid for in the year being lower than originally anticipated, the bidding opportunities available to the Group over the longer term remain at historical levels.

We anticipated that 2015 would be an important period for contract retention. Three material contracts were expected to be rebid in the coming year. However, in a similar way to our recent experience with new contract opportunities, the contracts have not been rebid but rather extended to Mears to beyond 2015.

Over time, we have learned that in addition to excellent service delivery, strict bidding practice and innovation is essential in Social Housing. We appreciate that clients and competitors are under enormous pressure in an increasingly complex market with challenging underlying needs. We have become more aware this year of a material number of contracts held by competitors that are unsustainable either in terms of service delivery, financial viability or both. We are confident that over the next 18 months, our patience will be rewarded and our differentiated model vindicated, as these contracts reach breaking point. This point is illustrated by our appointment by Sutton Housing Partnership (SHP), which we mobilised over a period of two days in late December 2014. This contract was awarded on an emergency one-year basis after the exit of the incumbent contractor. The contract covers 6,000 homes in the London Borough of Sutton, delivering responsive repairs, voids and a planned maintenance programme. The contract mobilisation has gone extremely well, especially given the short timescales; our new client has experienced an immediate improvement in quality.

Our clients are looking to consolidate and transform an array of housing management activities, such as planning and asset management, income optimisation, lettings and the operation of related call centre infrastructure. The market for these types of white collar activities is significant at circa £4 billion per year, and is largely untouched by the private sector. An evolving Social Housing market, following recent changes in the welfare system and tenancy arrangements, over and above the ongoing pressure on budgets generally, has increased the pressure on our clients to rethink how best to meet the needs of not only existing tenants but also the 3 million potential tenants on long Social Housing waiting lists. Recognising how Mears has worked in partnership with them in the past to address more broad-based blue collar challenges, we have been encouraged to collaborate to tackle the sector's housing management issues.

During October 2014, Mears completed the acquisition of the Omega Group (Omega). Omega is a leading private sector provider of residential lettings and management services to the Social Housing market, with a portfolio of circa 1,700 properties and a client base of 24 Local Authorities and Housing Associations. The acquisition of Omega is in line with the Group's strategic aim to continue growing in the evolving Social Housing market, adding further innovation to Mears' housing management offering and is sympathetic to our partnership ethos.

Mears Housing Management Services is a logical extension of the services provided within our Social Housing division. It aims to add value to the existing client base and to enhance our service offering. These new services have been established to work with housing providers to improve the delivery of housing and property management services and to increase the supply and management of housing. Our aim is to provide housing and property management services to our public sector clients, driving efficiency and better value in targeted communities.

Mears has a strong track record of turning around, integrating and extracting substantial value from acquired businesses, along with an excellent reputation for service delivery. As we look to broaden the services we offer across the sphere of Social Housing, we will look to make further acquisitions to reinforce our market-leading position.

## Social Housing

**Revenue** **Operating profit*** **Operating margin***


* Before amortisation of acquisition intangibles, exceptional items and long-term incentives.

**In focus**
Mears and North Lanarkshire Council, a unique JV.
**page 29**

**In focus**
Mears' acquisition of Omega Lettings.
**page 30**

# **Review of operations** continued

## **Social Housing – business development** continued

The state of the housing market will feature highly in the run up to the General Election this year. All major political parties recognise that a correctly functioning housing market is central to the economic and social success of communities and the nation as a whole. The demand for affordable housing, whether that be at a social rent or a near market rent, is very high with circa 1.7m households on waiting lists in England and Wales. Recent research has concluded that circa 3m adults between the ages of 20 and 34 still live with their parents.

Local Authorities, especially those that have retained their housing stock, have been propelled to centre stage as leading players in bridging the gap caused by the national shortfall in housing supply. The revised financial settlement which came into being in April 2012 has proved productive for Local Authorities and has given many an increasing headroom for investment. However, that headroom, reflected in surpluses, has not yet generated major investment.

## Social Housing – new contract bidding

**The Group has increased its historical Social Housing new contract win rate to 35% (by value) (2013: 33%) and secured new work with a total value in excess of £170m (2013: £420m). The most significant awards are detailed below.**

| Contract | Detail |
|---|---|
| Sutton Housing Partnership | Mears was awarded a contract to repair and maintain 6,000 homes. This followed the termination of the previous provider. The contract is anticipated to be worth £4m in 2015. |
| Medway Council | Mears was re-awarded a new five-year repair and maintenance contract for its 3,000 properties, with the new contract starting in August 2014. The total contract value is estimated at £20m. Works include response and void maintenance together with modernisations and large maintenance projects such as new kitchens and bathrooms. |
| London Borough of Sutton | Mears has won a housing management contract to refurbish an ex-care home which has been unoccupied for several years. The contract entails the conversion of the ex-care home into 43 units of self-contained accommodation for use as temporary accommodation. Mears will provide lettings, housing management, security and temporary accommodation services over the ten-year lease period. |
| Central Bedfordshire Council | Mears has won a contract to provide lettings, housing management and temporary accommodation services in the Central Bedfordshire area. This contract, which will support Central Bedfordshire Council by placing homeless households into quality and affordable private sector rented accommodation, further strengthening Mears' presence in the Home Counties. |
| East Thames Housing | Mears has been awarded a contract to lease, refurbish and manage a total of 210 properties in East London earmarked for demolition and regeneration. The services will involve refurbishment, lettings, housing management and temporary accommodation services over the lease period. The deal further strengthens Omega's resolve of bringing empty properties back into use to increase the supply of affordable accommodation. |
| Preferred bidder status – partner with the Department of Communities and Local Government (DCLG) | Mears has been appointed preferred bidder with the DCLG for the commercialisation of its Planning Portal. This strengthens our housing management services and represents an exciting opportunity to broaden our services as well as providing a further point of access into every Local Authority in England and Wales. The Planning Portal is a web-based one-stop shop for advice and guidance on planning, building regulations and appeals. It is the sole electronic means to submit a planning application, with links to all Local Authorities in England and Wales. Some 80% of planning applications go through the Portal and DCLG believes the Portal has commercial value as well as opportunities to grow revenue. It is on this basis that it approached the market to locate a partner to take on the running costs of the service and further develop it into a truly commercial business. |

In addition to the new contract awards, a number of material contracts, which had originally been due to come up for renewal in 2015, have been subject to extensions, notably Gateshead (extended to 2017), Sedgefield (extension anticipated to 2016) and Birmingham (extended to 2016).

## Mears working in partnership with North Lanarkshire Council

**Mears is currently in year four of a ten-year partnership with North Lanarkshire Council, the fourth largest Authority in Scotland, delivering reactive and void repairs to the Council's full housing and property portfolio.**

The housing stock consists of approximately 37,000 homes including low, medium and high rise and a number of sheltered housing developments with a repairs budget in excess of £28m per annum.

The non-housing stock consists of approximately 730 sites including schools, offices, care centres and recreational facilities.

Mears also delivers around £8m of additional works including Scottish Housing Quality Standard works and one-off capital projects such as:

- kitchen and bathroom installations;
- office refurbishment;
- completion of a daycare centre; and
- school boiler replacement.

Since the start of the contract over 80 new apprenticeships have been created.

## Our Social Housing strategy

We have maintained a consistent strategy over the last 15 years, which is summarised below:

| Strategic focus | Delivery |
|---|---|
| Differentiate on customer service leadership as the prime driver of sustainable growth | Record level of customer satisfaction achieved in 2014. |
| Support our clients to obtain maximum benefit from the opportunities presented by Government and funding | Provision of a full asset management capability to ensure appropriate investment in housing stock refurbishment. The acquisition of Omega further advances the Group's capability. |
| Focus on building long-term partnerships | Retention of key client relationships in 2014, including Thurrock and Octavia and material contract extensions in Gateshead and Leeds. Successful development and introduction of new partnership models such as our joint ventures in Manchester and North Lanarkshire. |
| Drive innovation to provide better outcomes for tenants | Investment in the development of housing management services and further enhancement to our Mears Direct model, which provides solutions for clients who wish to insource their maintenance services. |
| Develop a skilled and motivated workforce | Achieved top 100 employer status in the UK for apprentices. Extensive investment in training and development of staff at all levels. |
| Consider acquisitions to supplement our capabilities and support our increasing service breadth | Pipeline of potential housing management acquisitions to reinforce our leadership position but greater focus is upon organic growth. |

# **Review of operations** continued

## Housing management

**Through our acquisition in 2014 of Omega Lettings, we received full planning permission from the London Borough of Sutton in December 2014 to convert a disused Council-owned building into 43 self-contained flats housing 123 people.**

The scheme is a partnership with the Council and will provide excellent living conditions for families in emergency housing need who would have otherwise been living in bed and breakfast accommodation.

The development is fully funded through existing housing benefit levels, meaning there is no cost to Sutton Council. In fact, the conversion will generate efficiency savings as the Council no longer pays for the cost of bed and breakfast accommodation for the resident families, the cost of security at the empty building or the loss of council tax on the property.

## Care

The Board is pleased with the performance of the Care division in terms of both the quality of service delivery and the solid financial performance.

The Care division reported revenues of £124.0m (2013: £123.1m), growth of 1%. This growth reflects a full-year impact from ILS, acquired in April 2013, without which the underlying business would have reported a reduction in revenues. The reduction, taken in isolation, is disappointing. Significant progress has, however, been made in developing the business and in the wider market. The main limitation to growth in Care remains in sourcing sufficient care workers of good quality; this challenge will only increase as we move forward and we are focused on finding solutions to address this. There remains more work available than we can responsibly service. Maintaining both service quality and margin remain the primary drivers for the Group.

We are pleased that the operating margin at 7.8% has been maintained at the levels achieved in the prior year, despite our significant investment in improving the terms and conditions of our workforce. We are committed to improving the terms and conditions of our carers, notably our aspiration to increase pay rates towards the living wage and a movement away from zero-hour contracts. We still have a long way to go to achieve this and further progress will require the care commissioners to share this ambition.

### Care – business development

We entered the Care market in 2007 with a clear strategic vision that the market would develop in a similar way to Social Housing. Notably, we expected to see a shift towards outcome-based contracts, where vendor payments are based on the quality of the outcome for the recipient rather than simply based on the time spent in delivering the service. We also expected to see customers move toward awarding contracts for longer terms to fewer providers, who could provide broader services and who could also assist in driving efficiencies within clients' cost bases. We have positioned ourselves as a high quality business focused upon service delivery in readiness for the market change. The speed of change has been slow; however, strong momentum has now built up which endorses our strategy.

The award of the Torbay contract is another crucial milestone for Mears and represents a further important development in the UK Care market. While still early days, there are indications now that a number of other Local Authorities are looking to follow the lead of Wiltshire County Council and now Torbay. We share absolutely the vision for Torbay and are committed to harmonising standards, integrating IT systems and achieving great outcomes for all clients. Local providers will continue to play an important role in the delivery of care and support in Torbay.

We are seeing a positive move in the structure of tendered opportunities, in-line with our predictions at the time we entered the Care market. The majority of new opportunities are now leading to a consolidation in the number of providers, with several Councils

## Mears driving up standards in the home care workforce

In spring 2014, Mears initiated a cross-party commission to examine the future of the home care workforce. The Rt Hon Paul Burstow MP (the former Minister of State for Care and Support) chaired the commission, which heard evidence from across the home care sector.

The commission launched its report in December 2014, receiving a substantial amount of media coverage. The commission calls for:

- **Key worker status for home care workers and a living wage.** Care workers provide the hands-on care that is the key to our social care system. They deserve to be fairly compensated and have their contributions recognised and rewarded.
- **Minimum payments for contact hours.** Councils should ensure that they are paying a sufficient rate for contact hours, which ensures that providers can cover travel time, and we should be working towards the living wage for care workers.
- **A shake-up of care commissioning and better oversight of existing contracts.** Councils need to focus more on person-centred outcomes and be more proactive in ensuring that their use of existing framework contracts is not contributing to the worst practices in home care, such as call cramming.
- **A training and career pathway for care workers.** Care workers in both health and social care need minimum standards of training that can be developed into pathways of specialism. A more formalised career path would include apprenticeships alongside clear career pathways.

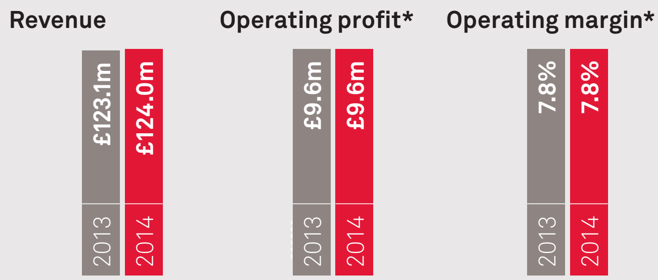
With the right support and investment the crucial role that care workers play can be recognised as a career of esteem that will safeguard the future of our ageing population.

adopting strategic partnering arrangements. This change has been driven by the need to deliver new service models through greater integrated working with the NHS and by the need to address financial challenges. Contract lengths are also improving from an average of 2.5 years in 2012, to over three years in 2014. Those looking at strategic partnerships typically have contract lengths of five to eight years. We anticipate this change will continue at a pace over the next few years.

Our higher acuity Nurseplus activities have made strong progress since acquisition in April 2013, driven from securing new high acuity packages with the existing Mears client base, which had not been served previously. The business has now been integrated fully and the structure of the Care business has been further enhanced under two divisional managers covering the north and south of the UK, together with an additional ten technical case managers; this is a significant investment in an area of Care which we expect to deliver significant growth.

Social Care continues to be a focus for society at large and, consequently, further evolution of the market may be expected. Councils are striving to protect spending on adult care as their overall budgets come under pressure due to the prevailing environment of austerity. These financial pressures are being offset by a phased programme of budget transfer from the NHS, announced last year, to promote better joint working between the 'free' at the point of delivery NHS and 'means tested' local domiciliary and residential care services. The greater integration of the NHS can be seen in the proportion of opportunities involving complex services, having grown from one in four in 2012 to approaching one in two of all tenders in 2014.

### Care




* Before amortisation of acquisition intangibles, exceptional items and long-term incentives.

**In focus**
Mears' Nurseplus partnership with the NHS.
**page 32**

**In focus**
A new commissioning model is transforming the sector.
**page 31**

# **Review of operations** continued


## Partnership working with the NHS

**Mears Nurseplus is already playing an active role in helping to alleviate some of the pressures on demand for hospital beds.**

After two years in an intensive treatment unit, Mr B was assessed as fit for discharge from hospital. Prior to discharge, a multi-disciplinary team consisting of consultants, social services and Mears Nurseplus was created to oversee the transition from hospital to 24-hour home care.

Before Mr B was able to return home, minor adjustments were required to the family home. Mears Nurseplus met with Mr B's wife and an architect to discuss the work required and the practical adjustments needed for a safe discharge.

The Mears Nurseplus staff selected by Mr B began their training programme by shadowing Mr B's named nursing team and allied health professionals. The home ventilation team and the complex care team provided specialist training to ensure that the Mears Nurseplus team was competent in all aspects of Mr B's care regime.

Following discharge, NHS staff and social workers visited Mr B regularly to assess the care delivery. Mr B is now happily settled back home and is starting to rebuild his life with his wife and three children.

## Our Care strategy

Our Care strategy has evolved prudently over several years, reflecting the often slow speed of change is now the sector. The positive moves we are seeing in the structure of tendered opportunities are in line with our predictions and the momentum of change is now building and is positive. Our strategy seeks to reinforce this momentum and to benefit from it:

| Strategic focus | Delivery |
|---|---|
| Focus on delivering high quality care through the development of outcome-based working, as opposed to the traditional care focus on task and time | Our Wiltshire contract, which commenced in 2013, is very much the flagship for this development. Within Wiltshire, all care plans are written based upon achieving specific outcomes for individual service users. We agree a budget and a timeframe to achieve these outcomes and payments are linked to our success. |
| Deliver sustainable pricing | We are focusing on those contracts that allow us to recruit a workforce delivering a high quality service. This has resulted in a further tightening of our bid/no bid decisions, which included our not rebidding for one of our existing relatively high volume, but low priced, contracts. |
| Invest in the workforce to ensure both motivated and well trained | We have agreed new minimum pay levels for our staff which are set ahead of national minimum wage with a further significant enhancement for those working within the London area. We are also investing further in training and a range of other benefits. We believe this investment is fundamental to help reduce the staff churn rate; as such, this investment should be self-funding over the long term. |
| Evolve the breadth and depth of service offering | Increasing integration of NHS and social services is growing the number of people with more complex conditions who need care at home. Complex care covers services such as spinal injuries, head injuries, end of life care, dementia care and learning disabilities. Given the potential of this area, we will invest in our own Mears Nurseplus infrastructure and in a number of regional clinical leads who can develop local relationships with Clinical Commissioning Groups (CCGs). |
| Consider acquisitions to supplement our capabilities and support our increasing service breadth | Our focus is on identifying any complex care businesses that can assist in the scaling up of a full national presence. We are looking for quality operations which, when combined with our own organic investment, will enable us to build a leadership platform across all levels of care in the home. |

## Care – new contract bidding

In Care, the contract bidding success rate (by value) of all contracts bid was 73%, amounting to a total value of £130m (2013: £96m, 69%), including the amounts shown in the table below.

| Contract | Detail |
|---|---|
| Torbay and Southern Devon NHS Trust | Mears Care has been awarded a 5 + 3 year contract, estimated to be worth £50m. Mears is the single prime contractor to deliver Living Well@Home Services across Torbay and Southern Devon.<br>The innovative service delivery model integrates personal care and more complex healthcare at home (overseen by Mears Nurseplus) and mental health and learning disability support services, together with housing related and community support. Outcome-based payments will be implemented as soon as possible after the contract commencement date. |
| NHS Rotherham CCG | A three-year contract worth £3.7m for domiciliary care, end of life services and complex care for service users with learning disabilities and/or physical disabilities, including spinal injuries and ventilated patients. |
| Plymouth Council | We have been awarded a three-year contract worth £5.5m. Services include a two-hour rapid response service and support for people with dementia, learning and physical disabilities. The contract will also promote joint working with the NHS. |
| Stirling and Clackmannanshire | We have retained our major contracts with Stirling and Clackmannanshire, which came as part of the ILS acquisition. The two contracts are for four years of personal care and support services worth an estimated £18m over four years. |
| Calderdale Council | Mears was awarded a new three-year contract for personal care and support worth £8.5m over three years. |

### Care – business development continued

The Better Care Fund is already having a significant impact at a local level with all Councils drawing up plans with NHS Clinical Commissioning Groups around the transfer of funds from the NHS into community-based care and support. The £5 billion+ Better Care Fund will start to have a more significant impact from the middle of 2015.

Virtually all tenders now include an element of outcome-based reward (compared to 2012 when all tenders were task and time based). There are a number of such opportunities in the pipeline in which outcome-based elements will be significant. We are working on an outcome basis in our Wiltshire contract.

The Health and Social Care Act, which came into force on 1 April 2013, established Health and Wellbeing Boards to promote this more efficient and productive local integration. This has now been re-enforced by the Care Act 2014, which comes into force this year and will see greater focus on outcome-based reward, integrated working and prevention activities. The Care Act also provides for the introduction of the £72,000 care funding cost cap for individuals in 2016, following recommendations from the Dilnot report. This will increase the number of people receiving public funded care.

### Positive outlook for the Group

We operate in robust and defensive markets where spend is largely non-discretionary. We continue to place great emphasis on winning high quality contracts that provide clear and sustainable margins with good cash flow dynamics. Our dedication to providing our clients with first class service and value remains undiminished.

We expect our Social Housing business to continue to grow through further contract wins. Although we are the market leader, we deliver services to just 15% of the UK Social Housing stock which leaves us significant further growth opportunities given our differentiated market-leading positioning.

We see the development of our housing management services as an important extension of our Social Housing offering. The demand for affordable housing will provide opportunities to work with housing providers to improve the delivery of housing and property management services and to increase the supply and management of housing through innovation and partnership. Currently, this area is highly fragmented and undeveloped. We believe the Group is well positioned to progress and deliver strong organic growth. Where appropriate, we will make acquisitions to develop the breadth of our services and enhance our scale.

We are confident that further opportunities in Care will grow from health and social care outsourcing and the implementation of new localised commissioning models. Consequently, we will continue to move further up the acuity chain, with an increased focus upon organic growth, extending our Nurseplus model across our clients with this growth being supported by in-fill acquisitions.

In closing, since the turn of the year, trading remains in line with our expectations and we look forward to another year of progress across the Group.

**D J Miles**
**Chief Executive Officer**
david.miles@mearsgroup.co.uk
17 March 2015

# Financial review

This Financial Review provides further key information in respect of the financial performance and financial position of the Group.

**Andrew Smith**
Finance Director

## In summary

### Earnings

- The normalised diluted EPS, which allows for the potential diluting impact of outstanding share options, increased by 15% to 32.20p (2013: 28.06p).

### Dividend

- The Board has recommended a final dividend of 7.15p per share which, combined with the interim dividend, gives a total dividend for the year of 10.00p (2013: 8.80p), a 14% increase.

### Cash

- The efficiency with which the Group manages working capital remains a cornerstone of its business. The Group's conversion of EBITDA to cash in the period was 96% (2013: 103%).

Read the Report of the Audit Committee on **pages 46 to 49**

View the primary statements on **pages 81 to 85**

**Group revenue**

**£838.7m**

(2013: £865.6m)

**Dividend per share**

**10.0p**

(2013: 8.80p)

**Group operating profit***

**£43.0m**

(2013: £41.1m)

**Cash conversion – continuing activities**

**96%**

(2013: 103%)

* Before acquisition intangible amortisation and exceptional costs.

## Financial performance

This Financial Review provides further key information in respect of the financial performance and financial position of the Group, to the extent that this is not already covered within the Chief Executive's Review of operations.

## Acquisition of Omega Group

During October 2014, Mears completed the acquisition of the Omega Group (Omega), a leading private sector provider of residential lettings and management services to the Social Housing market, with a portfolio of circa 1,700 properties and a client base of 24 Local Authorities and Housing Associations.

The initial consideration for the acquisition was £20.0m in cash, funded from Mears' existing banking facilities. A further consideration of £1.8m was paid to normalise the level of working capital at completion. Additional contingent consideration is payable in instalments in the event that average EBITDA over a 36 month period to 31 October 2017 exceeds £3.4m per annum. The additional consideration payable will be an amount based upon a multiple of 6.8 applied to the average EBITDA, less the initial consideration of £20m paid, with total consideration capped at £41.8m. The deferred consideration will be satisfied using either cash or shares, at the discretion of the Company.

## Exceptional costs

It is pleasing to report a set of numbers where all transactions are included within normal trading. This followed the previous year, which had seen the Group dispose of its non-core Mechanical & Electrical business resulting in a loss on disposal of £18.8m together with integration and restructuring costs of £6.5m following the acquisition of Morrison Facilities Services Limited in late 2012. Whilst extracting certain non-recurring items can at times be a necessity to ensure the financial statements properly reflect underlying trading, it has always been our strong preference to keep our normalising adjustments to a minimum.

The Group inherited a number of financial challenges with the acquisition of Morrison which naturally brought with it an increased level of uncertainty. Our focus upon service delivery and a commitment to invest in those contracts has enabled us to resolve the key financial challenges positively and has placed the ex-Morrison contracts on a sound footing. The introduction of the Mears systems and proven operational processes drove through further improvements. Inevitably there were some positive and negative variances as judgements and estimates were revised in the light of changing circumstances; however, these combined to give a neutral impact to 2014 trading and underlying trading remains consistent.

## Amortisation of acquisition intangibles

A charge for amortisation of acquisition intangibles of £12.3m (2013: £10.9m) arose in the period. This charge relates to a number of acquisitions in both Social Housing and Care over recent years. The increase in the period is principally driven by the full-year impact of ILS Group, acquired in May 2013, together with the impact of the acquisition of Omega in October 2014, which generated an identified acquisition intangible of £8.2m and which is to be amortised over a period of between five and twelve years.

## Net finance charge

A net finance charge of £1.3m has been recognised in the year (2013: £1.8m).

The finance cost in respect of bank borrowings was £2.8m (2013: £3.2m). The small decrease reflects the reduction in average debt. The Group has two interest rate swaps which has fixed LIBOR at a blended rate of 1.87% on the first £57.5m of its borrowing. The remaining debt bears a variable LIBOR rate that has been in the region of 0.5% throughout the period. The Group pays a margin over and above the LIBOR which is subject to a ratchet mechanism but which is typically at the lower end of the range of 1.5% to 2.5%.

The finance costs also include other interest of £0.3m (2013: £0.4m) relating to the discounting of trade receivables and provisions to properly reflect the time value of money.

The net finance income in respect of defined benefit pension scheme was £1.8m (2013: £1.7m).

## Share of profit in joint ventures

The acquisition of Omega included two joint ventures where the Group has an interest in 50% of the share capital of the related entity. Whilst the Group has joint control over their activities, it does not have outright control and therefore the results of the joint ventures are not consolidated in the Group results and are incorporated within a single entry on the face of the Group Income Statement. In the period since acquisition, the joint ventures generated a profit of £0.6m of which half is recognised within the Group Income Statement.

## Tax expense

| | **2014 £m** | 2013* £m |
|---|---|---|
| Current tax recognised in Income Statement | **4.7** | 3.4 |
| Deferred tax recognised in Income Statement | **(0.3)** | 1.4 |
| Total tax expenses recognised in Income Statement | **4.4** | 4.8 |
| Profit before tax and before amortisation of acquired intangibles | **42.0** | 32.6 |
| Profit before tax | **29.7** | 21.7 |
| Effective current tax rate | **11.2%** | 10.2% |

* Continuing activities.

The tax charge for the year was £4.4m (2013: £4.8m). The headline rate of corporation tax for the year was 21.5% (2013: 23.3%). The effective current tax recognised in the income is significantly lower than the headline rate due to the utilisation of losses brought forward, primarily associated with Morrison, combined with an annual corporation tax deduction in respect of the exercise of share options. For the same reason, the Group has also enjoyed a reduction in the cash outflow from corporation tax of £2.3m (2013: £3.1m).

The headline rate of corporation tax will reduce to 20.3% in 2015 in line with tax legislation. We anticipate the gap between the headline rate and effective rate will narrow moving forwards; however, corporation tax losses carried forwards together with an annual corporation tax deduction in respect of the exercise of share options, are likely to maintain an effective rate below the headline rate over the medium term.

The Group continues to follow a non-aggressive policy in respect of taxation and this behaviour, combined with an excellent record of tax compliance, continues to provide the Group the benefit of an HMRC low risk status.

# Financial review continued

## Earnings per share (EPS)

| | 2014 p | 2013 p | Change % |
|---|---|---|---|
| Diluted earnings per share – continuing activities | **24.65** | 16.96 | +45% |
| Normalised diluted earnings per share – continuing activities* | **32.20** | 30.08 | +7% |
| Normalised diluted earnings per share – all activities* | **32.20** | 28.06 | +15% |
| Dividend per share | **10.00** | 8.80 | +14% |

* Before acquired intangible amortisation, exceptional costs with an adjustment to reflect a full tax charge.

The normalised diluted EPS, which allows for the potential dilutive impact of outstanding share options increased by 15% to 32.20p (2013: 28.06p). Normalised earnings are stated before exceptional costs and exclude the amortisation of acquisition intangibles together with an adjustment to reflect a full tax charge of 21.5% (2013: 23.3%). We believe that this normalised diluted EPS measure better allows the assessment of operational performance, the analysis of trends over time, the comparison of different businesses and the projection of future performance.

## Cash performance

| | 2014 £m | 2013* £m |
|---|---|---|
| Operating profit** | **43.0** | 41.1 |
| Exceptional costs with cash impact | **—** | (8.8) |
| Depreciation | **5.5** | 5.6 |
| Adjusted EBITDA | **48.5** | 37.9 |
| Cash inflow from operating activities | **46.4** | 38.9 |
| EBITDA to cash conversion | **96%** | 103% |
| Net cash/(debt) at balance sheet date | **3.8** | (0.4) |
| Average debt in year | **59.0** | 70.0 |
| Core debt at the year end | **75.0** | 70.0 |

* Continuing activities.

** Before amortisation of acquisition intangibles and exceptional items.

The efficiency with which the Group manages working capital remains a cornerstone of our business. The Group's conversion of EBITDA to cash in the period was 96% (2013: 103%). The Group has consistently set high standards of working capital management and high levels of conversion of profit into cash. Given the absence of growth in the top line in 2014, the achievement of strong cash conversion might be viewed as easy; however cash collection in a high volume, low value and public sector environment always represents a challenge and we are delighted at this continued strong performance.

Our net cash position at 31 December 2014 was £3.8m (2013: net debt £0.4m). Whilst the year end cash position was pleasing, typically the accounting period end has a low debt balance when compared to the rest of the year. A far more important metric is the Group's daily net debt balances which provide a better indication of working capital management. The average net debt over the year, excluding the Omega transaction, showed a reduction to £59.0m compared to core debt in the previous year of £70.0m.

The Group has a £120m unsecured revolving credit facility expiring in 2018. The Group continues to maintain a strong relationship with both of its bankers, Barclays and HSBC.

## Balance sheet

| | 2014 £m | 2013 £m |
|---|---|---|
| Goodwill and intangible assets | **227.4** | 193.6 |
| Investment in joint ventures | **1.9** | — |
| Property, plant and equipment | **15.9** | 15.1 |
| Inventories | **8.5** | 10.5 |
| Trade receivables | **142.6** | 151.6 |
| Trade payables | **(187.1)** | (197.0) |
| Net debt | **3.8** | (0.4) |
| Deferred consideration | **(21.0)** | (1.8) |
| Cash flow hedge | **(1.4)** | (1.2) |
| Pension (net of deferred tax) | **5.4** | 6.8 |
| Taxation | **(1.5)** | 3.0 |
| **Net assets** | **194.5** | 180.3 |

## Acquisitions and intangible assets

The value of goodwill and other identified intangibles carried within the balance sheet is £227.4m (2013: £193.6m). The significant increase during the period was due to the acquisition of Omega, which created an intangible asset of £8.2m and goodwill of £32.9m.

A total of £12.3m (2013: £10.9m) of amortisation on acquisition intangibles was charged to the Group Income Statement during the period.

## Other trading balances

The Group capital expenditure of £4.5m (2013: £4.2m) relates to IT hardware, other office equipment and the refurbishment of new office premises. Predominantly all our plant and machinery is hired and motor vehicles are subject to operating leases and hence are not included within capital expenditure or recognised as an asset within the balance sheet. In addition, development expenditure was incurred in developing the in-house IT platform of £1.5m (2013: £1.2m). We would anticipate our capital expenditure in property, plant and equipment be maintained at a similar level in 2015. However, following our success in being awarded the position as joint venture partner to the DCLG, we would envisage development expenditure recording a spike to around £3.5m in the three years to 2017 before reducing to the historical level.

Trade receivables and inventories decreased to £151.1m (2013: £162.1m), which reflects a combination of reduced revenues and strong working capital management. Trade payables decreased to £187.1m (2013: £197.0m), in line with revenues.

Total equity rose by £14.2m to £194.5m at 31 December 2014. The increase in net assets is driven by retained profits.

## Pensions

| | **2014 £m** | 2013 £m |
|---|---|---|
| Pension asset | **15.1** | 14.7 |
| Pension liability | **(8.4)** | (6.1) |
| **Net asset** | **6.8** | 8.6 |

The Group participates in two principal Group pension schemes (2013: two) together with a further 28 (2013: 30) individual defined benefit schemes where the Group has received Admitted Body Status in a Local Government Pension Scheme. At the point of tendering for new contract opportunities, the Group seeks to minimise its exposure to future changes in the required pension contribution rates and to future liabilities resulting from scheme deficits.

We have experienced significant tightening in our pension assumptions reflecting the changing market conditions and this has resulted in an increase in liabilities in the current year.

The Group's largest single scheme is the Morrison Facilities Pension Scheme, which is predominantly attached to our North Lanarkshire contract. This scheme currently enjoys a net asset position of £15.1m (2013: £14.7m). Whilst a small increase in the carrying value of the asset is pleasing, the Board is mindful that valuations can fluctuate. Importantly, based on the latest triennial valuation, dated April 2012, the scheme reported a surplus of £4.8m utilising a more prudent set of assumptions based on the statutory funding principles. The IAS 19 actuarial valuations for the other schemes as at December 2014 reported a deterioration following the increase in scheme liabilities, with an increase in the net pension liability by £2.3m to £8.4m.

The Group continues to comply with a repayment plan agreed with the trustees of the Mears Group scheme whereby the Group will pay £1.0m per annum for a period of seven years with a view to the scheme being fully funded by 2020.

**A C M Smith**
**Finance Director**
andrew.smith@mearsgroup.co.uk
17 March 2015

The Strategic Report was approved by the Board of Directors on 17 March 2015 and signed on its behalf by:

**D J Miles**
**Chief Executive Officer**
david.miles@mearsgroup.co.uk

# Introduction to corporate governance

We are committed to achieving high standards of corporate governance. Effective corporate governance is essential to facilitate the success of the Company.

## Dear shareholder,

At Mears, we are committed to achieving high standards of corporate governance. We seek to create a working culture where honesty, openness and fairness are valued.

We seek to maintain the highest standards of corporate governance as this will help to facilitate the success of the Company and sustain this over time. An important distinction between the management, led by David Miles, Chief Executive Officer, and the Board is that the management are responsible for running the business while the Board, acting under my leadership, provides the constructive challenge to the management necessary to create accountability and drive performance. This results in an environment that creates and preserves value for shareholders.

The composition of the Board is vital to ensure that we have the right mix of skills and experience, ensuring that Board members have sufficient knowledge of the Company whilst maintaining their independence and objectivity. I am fortunate as Chairman to be able to call upon a Board with a broad range of expertise and specialisms.

Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis. This year's review was externally facilitated, with an independent reviewer meeting with all Board members individually. The Directors were asked for their views on a broad range of areas including Group strategy, independence, experience, effectiveness, shareholders and the interaction between Board members. Some improvements were proposed and implemented, but overall the Board was felt to be working effectively.

**R Holt**
**Chairman**
bob.holt@mearsgroup.co.uk
17 March 2015

The Board is responsible for the Group's system of corporate governance and is ultimately accountable for the Group's activities, strategy and financial performance. The Board is dedicated to upholding and achieving good standards of corporate governance, integrity and business ethics for all activities.

Your Board has due regard for the benefits of diversity in its membership, including gender, and strives to maintain the right balance. It comprises individuals with deep knowledge and experience in core and diverse business sectors within local, international and global markets, bringing a wide range of perspectives to the business.

**Length of tenure of Board**


**Non-Executive/Executive Directors**


Read the Report of the Audit Committee on **pages 46 to 49**

Read the Report of the Nomination Committee on **page 45**

# Your Board

**Bob Holt**
Chairman

Age: 60
Tenure: 18 years

Skills and experience: Bob had a controlling interest in Mears at the time of flotation in October 1996. He has a background in developing support service businesses. He has operated in the service sector since 1981, initially in a financial capacity then moving into general management.

**David J Miles**
Chief Executive Officer

Age: 49
Tenure: 18 years

Skills and experience: David joined Mears in 1996 and, prior to his appointment to the Board in January 2007, was Managing Director of the Mears Social Housing division. Prior to joining Mears, David held a senior position with the MITIE Group. His background is in electrical engineering.

**Andrew C M Smith**
Finance Director

Age: 42
Tenure: 15 years

Skills and experience: Andrew joined Mears in 1999 and, prior to his appointment to the Board, was Finance Director covering all of the Mears Group's subsidiaries. Andrew qualified as a Chartered Accountant in 1994 and worked in professional practice prior to joining Mears.

**Alan Long**
Executive Director

Age: 52
Tenure: 9 years

Skills and experience: Alan joined Mears in 2005 and, prior to his appointment to the Board in August 2009, he was Managing Director of the Group's Care division, having previously held the position of Group Sales and Marketing Director. Prior to joining Mears, Alan held senior roles for Britannia Building Society, Mars and Smith and Nephew.

**Michael G Rogers**
Non-Executive Director

Age: 73
Tenure: 7 years

Skills and experience: Michael founded Careforce in 1999 and has over 30 years' experience in healthcare services and care provision. In 1976 he joined Nestor Medical Group Limited as Managing Director and went on to become Chief Executive of Nestor Healthcare Group plc from 1986 to 1996. From 1996 to 1999 he worked as a consultant to a number of healthcare related organisations.

Board Committees: Remuneration Committee

**Peter F Dicks**
Non-Executive Deputy Chairman and Senior Independent Director

Age: 72
Tenure: 7 years

Skills and experience: Peter has been active in the venture capital and investment fields for a number of years. He is currently a Director of a number of companies. He joined Mears in 2008 and is Chairman of the Remuneration Committee.

Board Committees: Remuneration Committee (Chairman)
Audit Committee
Nomination Committee

**David L Hosein**
Non-Executive Director

Age: 51
Tenure: 7 years

Skills and experience: David has over 17 years' consulting experience, the last five of which have been at OC&C Strategy Consultants Limited where David is a Partner. David has worked extensively in the support services sector for corporate and private equity clients. Previously, he was a partner in Arthur Andersen. He joined Mears in 2008.

Board Committees: Nomination Committee

**Davida Marston**
Non-Executive Director

Age: 61
Tenure: 4 years

Skills and experience: Davida had a career in international banking and has served as a Non-Executive Director of several major companies in the UK and overseas. Current board appointments include Bank of Ireland and Liberbank. She has Social Housing experience having chaired the audit and risk committee for Midland Heart and its predecessor company, Keynote, as well as serving on the audit committee of Family Mosaic.

Board Committees: Audit Committee (Chairman)

**Rory Macnamara**
Non-Executive Director

Age: 60
Tenure: 4 years

Skills and experience: Rory is a Chartered Accountant with a wide range of corporate finance transaction experience. He was previously Vice Chairman and Head of Mergers and Acquisitions at Deutsche Morgan Grenfell and latterly a Managing Director at Lehman Brothers. He is currently a consultant to various companies and holds a number of Directorships.

Board Committees: Remuneration Committee
Audit Committee
Nomination Committee (Chairman)

**Ben Westran**
Company Secretary

Age: 38
Tenure: 11 years

Skills and experience: Ben is a Chartered Accountant and, prior to his appointment as Company Secretary, was Group Financial Controller and Director to a number of the Group's subsidiaries. Ben joined the Group in 2004 having previously worked in professional practice.

# Corporate governance report

The Board is responsible for the Group's system of corporate governance and is ultimately accountable for the Group's activities, strategy and financial performance. The Board is dedicated to upholding and achieving good standards of corporate governance, integrity and business ethics for all activities.

# Corporate governance framework

Responsibility for good governance lies with your Board. There is a strong and effective governance system in place throughout the Group.

## Chairman, Bob Holt

The Chairman is responsible for the leadership of the Board and ensuring its effectiveness on all aspects of its role. The Chairman sets the Board's agenda and ensures that adequate time is available for discussion of all agenda items, in particular strategic issues.

Read more on governance on **pages 41 to 45**

## The Board

### Audit Committee

The Audit Committee is responsible for effective corporate governance in respect of financial reporting, agreeing the scope of the external audit, the setting of their remuneration and reviewing the effectiveness of the Group's internal controls, risk management and internal audit processes.

**Committee members**

- Davida Marston (Chairman)
- Peter F Dicks
- Rory Macnamara

Read the Audit Committee Report on **pages 46 to 49**

### Remuneration Committee

The Remuneration Committee is responsible for assessing and making recommendations in respect of Executive remuneration.

**Committee members**

- Peter F Dicks (Chairman)
- Rory Macnamara
- Michael G Rogers

Read the Remuneration Committee Report on **page 50**

### Nomination Committee

The Nomination Committee is responsible for ensuring that the Board comprises a high level and range of business experience and skills to enable the Group to be managed effectively.

**Committee members**

- Rory Macnamara (Chairman)
- Peter F Dicks
- David L Hosein

Read the Nomination Committee Report on **page 45**

## Chief Executive Officer

The Chief Executive Officer manages the day-to-day business operations of the Group and recommends key strategies and implements those agreed by the Board.

Read the Operational Review on **pages 26 to 33**

## Senior Management Team

The Senior Management Team comprises Senior Executives across each of the Group's operational divisions and support functions and is the principal forum for directing the operational and financial business of the Group and for delivering the strategy set by the Board.

## Introduction

The Board is committed to maintaining the Group's operations in accordance with the highest standards of corporate governance as set out in the UK Corporate Governance Code (the 'Code') issued in 2012 and has complied with all Code principles and relevant provisions throughout the year.

## The Board of Directors

As at 31 December 2014, the Board had nine members comprising the Chairman, the Chief Executive Officer, the Group Finance Director, the Executive Director and five independent Non-Executive Directors. P F Dicks is the Senior Independent Non-Executive Director. The Directors' biographical details are set out on page 39. These indicate the high level and range of business experience which enables the Group to be managed effectively. Their mix of skills and business experience is a major contribution to the proper functioning of the Board and its Committees, ensuring that matters are fully debated.

Read the Corporate Governance Report on **pages 41 to 44**

The Board's prime objective is to ensure the ongoing commercial and financial success of the Group. The Board provides entrepreneurial leadership of the Group within a framework of prudent and effective controls which enable risk to be assessed and managed. The Board sets the Group's strategic aims, ensures that the necessary financial and human resources are in place for the Group to meet its objectives and reviews management performance. The Board sets the Group's values and standards and ensures that the Group's obligations to its shareholders and others are understood and met.

The Chairman, R Holt, is responsible for the leadership of the Board and ensuring its effectiveness on all aspects of its role. The Chairman sets the Board's agenda and ensures that adequate time is available for discussion of all agenda items, in particular strategic issues. The Chairman promotes a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors, in particular ensuring constructive relationships between Executive and Non-Executive Directors. The Chairman is also responsible for ensuring that the Directors receive accurate, timely and clear information.

The division of responsibilities between the Chairman and the Chief Executive Officer is clearly established and agreed by the Board. The Chief Executive Officer, D J Miles, manages the day-to-day business operations of the Group and ensures that the appropriate standards of corporate governance permeate throughout the organisation. A central part of his role includes recommending key strategies and implementing those agreed by the Board, communicating to shareholders and employees and allocating decision making and responsibilities accordingly. He takes a leading role in the relationship with all external agencies and in promoting Mears Group PLC.

### Chairman

- Responsible for the leadership of the Board and ensuring its effectiveness
- Sets the Board's agenda and ensures adequate time is available for discussion of all agenda items
- Promotes a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors
- Ensures that the Directors receive accurate, timely and clear information

### Division of responsibilities

The roles of the Chairman and the Chief Executive Officer are clearly established and agreed by the Board.

### Chief Executive Officer

- Manages the day-to-day business operations of the Group
- Ensures that the appropriate standards of corporate governance permeate throughout the organisation
- Recommends key strategies and implements those agreed by the Board
- Takes a leading role in the relationship with all external agencies and in promoting Mears Group PLC

# Corporate governance report continued

## Board responsibility

The Board maintains and regularly reviews a full list of matters and decisions that are reserved to, and can only be approved by, the Board. These are reviewed annually and include but are not limited to:

- Group strategy and operating plans;
- corporate governance and risk management;
- compliance with laws, regulations and the Company's code of business conduct;
- the approval of budgets;
- changes to the Group's debt and equity funding;
- appointment, termination and remuneration of Directors and the Company Secretary;
- financial reporting and audit, including interim and full-year results announcements and dividends;
- approving significant acquisitions, disposals and new business start-ups;
- values and ethics; and
- employee benefits including pensions and share-based payments.

Whilst the Board has specific responsibility for those matters reserved for its consideration, in certain areas, specific responsibility is delegated to Committees of the Board within defined terms of reference. The activities of these Committees are discussed in more detail later in this report.

## Independence of our Board

The balance and independence of our Board is kept under review by our Nomination Committee.

The Code suggests that the length of tenure is a factor to consider when determining independence. The table below shows the length of tenure for each Non-Executive Director.

**Length of tenure**

| Director | |
|---|---|
| D L Hosein | 7 years |
| M G Rogers | 7 years |
| P F Dicks | 7 years |
| D Marston | 4 years |
| R Macnamara | 4 years |

The Board considers that each of the Non-Executive Directors who served during the year is independent in terms of judgement and character and free from any relationship that might materially interfere with the exercise of independent judgement.

Notwithstanding this and for the sake of completeness, below is a summary of relationships of which shareholders should be aware:

- D L Hosein is a Director of OC&C Services Limited (OC&C) which has, in the past, received fees for work carried out for the Group; and
- M G Rogers became a Director of the Group in April 2007, on the acquisition of Careforce, where he continued as Chief Executive Officer in a purely transactional role, focused on Careforce and not involved in the Group business, until 2008 when he became a Non-Executive Director of Mears.

The Non-Executive Directors provide a strong independent element to the Board and bring experience at a senior level of business operations and strategy, constructively challenging and helping develop proposals on strategy. A summary of the terms and conditions of appointment of the Non-Executive Directors is available on request from the Company Secretary.

All Directors act in what they consider to be the best interests of the Company, consistent with their statutory duties.

The Non-Executive Directors constructively challenge and develop proposals on strategy and scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They determine appropriate levels of remuneration of Executive Directors and have a prime role in appointing and, where necessary, removing Executive Directors and in succession planning.

## Board membership and Board and Committee meeting attendance

All Directors are expected to allocate sufficient time to the Company to discharge their responsibilities effectively and, where possible, attend all Board meetings. Any time commitment matters would be addressed by the Chairman and the Director concerned. Please see the table opposite.

## Board meetings

The Board meets regularly throughout the year as well as on an ad hoc basis, as required by time-critical business needs. The Board receives detailed financial information and regular presentations from Executives on Mears' business performance. Directors are supplied with an agenda and supporting papers for all Board meetings on a timely basis along with minutes of previous Board and Committee meetings. This enables the Directors to make informed decisions on corporate and business issues under consideration. When Directors are unable to attend a meeting, they are advised of the matters to be discussed and given an opportunity to make their views known to the Chairman prior to the meeting. During the year, six scheduled Board meetings were held. In addition, the Directors attended two Group strategy days and several meetings regarding potential acquisitions.

### Board performance evaluation overview

The performance evaluation process included:
a review of the areas of Board responsibility;

- this year's review was externally facilitated, with an independent reviewer meeting with all Board members individually;
- the structure and composition of the Board and its Committees and the performance of the Committees;
- the quantity, quality and scope of information provided to the Board;
- the content of Board meetings and presentations to meetings; and
- the openness of communications between the Board members and Executive management.

## Board meetings continued

The Non-Executive Directors meet independently without the Chairman present, and also meet with the Chairman independently of management, on a regular basis.

The Directors delegate responsibilities for the day-to-day operational and financial management of the Group to the Senior Management Team, which comprises Senior Executives across each of the Group's operational divisions and support functions and is the principal forum for directing the operational and financial business of the Group and for delivering the strategy set by the Board.

## Evaluation of Board performance

Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis with the support of the Company Secretary. The Board undertakes formal evaluation of its own performance and the Board Committees assess their respective roles, performance and terms of reference and report accordingly to the Board. The Board assesses the reviews of each Committee.

This year's review was externally facilitated, with an independent reviewer meeting with all Board members individually. The Directors were asked for their views on a broad range of areas including Group strategy, independence, experience, effectiveness, shareholders and the interaction between Board members. Some improvements were proposed but overall the Board was felt to be working effectively.

The Chairman conducts individual appraisals with all Non-Executive Directors on an annual basis. The performance of the Chairman was reviewed separately in a process led by the Senior Independent Director.

Following the performance evaluation of individual Directors, the Chairman has confirmed that the Directors standing for re-election at this year's AGM continue to perform effectively and demonstrate commitment to their roles. Likewise the Senior Independent Director has given the same confirmation in respect of the Chairman. In line with current practice, all Directors will retire and, being eligible, offer themselves for re-election annually.

### Board membership and Board and Committee meeting attendance

| | Board | | Strategy days | | Audit | | Nomination | | Remuneration | |
|---|---|---|---|---|---|---|---|---|---|---|
| Number of meetings | Potential | Actual | Potential | Actual | Potential | Actual | Potential | Actual | Potential | Actual |
| R Holt | 6 | 6 | 2 | 2 | — | — | — | — | — | — |
| D J Miles | 6 | 6 | 2 | 2 | 4 | 4 | — | — | — | — |
| A C M Smith | 6 | 6 | 2 | 2 | 4 | 4 | — | — | — | — |
| A Long | 6 | 6 | 2 | 2 | — | — | — | — | — | — |
| M G Rogers | 6 | 5 | 2 | 2 | — | — | — | — | 2 | 2 |
| P F Dicks | 6 | 6 | 2 | 2 | 4 | 4 | 1 | 1 | 2 | 2 |
| D L Hosein | 6 | 6 | 2 | 2 | — | — | 1 | 1 | — | — |
| D Marston | 6 | 6 | 2 | 2 | 4 | 4 | — | — | — | — |
| R Macnamara | 6 | 6 | 2 | 2 | 4 | 4 | 1 | 1 | 2 | 2 |

# Corporate governance report continued

## Evaluation of Board performance continued

In particular the Board is strongly of the opinion that by their actions and conduct they demonstrate their independence. It is the Board's intention to continue to annually review its performance and that of its Committees and individual Directors. A decision is taken each year on the performance evaluation process to be used.

## Director development

Any Director, on appointment and throughout their service, receives an induction and is entitled to receive any training that is considered necessary to fulfil their responsibilities effectively. The Chairman regularly meets with each Director to review and agree any training and development needs.

All Directors have access to the Company Secretary, who is responsible for ensuring that Board procedures and applicable rules and regulations are observed.

## Board Committees

The Board delegates certain responsibilities to its principal Committees. The Audit Committee ensures the integrity of financial information, the effectiveness of the financial controls and the internal control and risk management systems. The Nomination Committee recommends the appointment of Directors and conducts a review of succession planning at Board and Operating Board levels. The Remuneration Committee sets the remuneration policy for Executive Directors and determines their individual remuneration arrangements.

The Chairperson of each Committee provides a report of any meeting of that Committee at the next Board meeting. Each Committee comprises Non-Executive Directors only, as required by the UK Corporate Governance Code 2012.

The Chairperson of each Committee is present at the AGM to answer questions from shareholders.

## The Company and its shareholders

The Company places a great deal of importance on communication with shareholders. The Board is committed to maintaining an ongoing dialogue with its shareholders through the provision of regular Interim and Annual Reports and regular trading reports.

There is regular dialogue with individual institutional shareholders throughout the year, together with the more formal presentations after the interim and preliminary results. Throughout the year the Group arranged a number of site visits for shareholders and other City commentators with the aim of providing them with increased exposure to our operations and management.

The Executive Directors respond on a daily basis to queries raised from both institutional and individual shareholders and analysts. The Senior Independent Director, together with other Non-Executive Directors, are available to meet shareholders upon request.

Regular consultation takes place between the Remuneration Committee and major shareholders prior to the adoption of any changes to incentive arrangements.

The principal methods of communication with private investors remain the Annual Report and Accounts, the interim statements, the quarterly newsletters and the Group's website (www.mearsgroup.co.uk), where the Group highlights the latest key business developments.

The Board encourages dialogue between the Directors and investors. Directors are available at each AGM and make themselves available for direct discussions with shareholders. Similarly the Directors meet Mears' debt providers regularly and are always keen to allow them significant access to Mears' operations, systems and management information. The Group values its close relationship with its banking partners, Barclays and HSBC.

The Board receives a regular summary of shareholder feedback communicated through the Company brokers. The feedback received over the last twelve months has generally been very positive. A consistent concern that has been raised by a number of shareholders relates to the perceived high level of reliance placed upon the Chief Executive Officer, David Miles. The Board has started to address this with the introduction of both divisional Chief Operating Officers at investor meetings to provide shareholders better visibility as to the strength in depth of the Mears Senior Management Team.

**P F Dicks**
**Senior Independent Non-Executive Director**
peter.dicks@mearsgroup.co.uk
17 March 2015

# Report of the Nomination Committee

## Introduction

**There is a formal, rigorous and transparent procedure for the appointment of new Directors to the Board. The search for Board candidates is conducted, and appointments made, on merit, against objective criteria and with due regard to the benefits of diversity on the Board, including gender.**

All Directors are able to allocate sufficient time to the Company to discharge their responsibilities. The Board has plans in place for orderly succession for appointments to the Board and to senior management. These plans aim to maintain an appropriate balance of skills and experience within the Company and on the Board and ensure progressive refreshing of the Board.

**R Macnamara**
**Nomination Committee Chairman**
rory.macnamara@mearsgroup.co.uk
17 March 2015

## Role of the Committee

The Nomination Committee's responsibilities include:

- keeping under review the composition of the Board and succession to it and succession planning for senior management positions within the Group;
- making recommendations to the Board concerning appointments to the Board, whether of Executive or Non-Executive Directors, having regard to the balance of skills, knowledge, experience and diversity of the Board;
- making recommendations to the Board concerning the re-appointment of any Non-Executive Director at the conclusion of his/her specified term and the re-election of any Director by shareholders under the retirement provisions of the Company's Articles of Association;
- managing a formal, rigorous and transparent procedure for any appointments of new Directors to the Board;
- prior to the appointment of a Director, requiring that the proposed appointee discloses any other business interests that may result in a conflict of interest and report any future business interests that could result in a conflict of interest; and
- ensuring that, on appointment to the Board, Non-Executive Directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, Committee service and involvement outside Board meetings.

The Committee formally met once during the year and all members of the Committee were present at the meeting. In addition, to its formal meeting, there was regular contact between committee members as well as ad hoc meetings with other Board members and management. During the year, the Committee considered the membership of each Board Committee and updated its succession plans for Executive and Non-Executive Directors and senior management. This year the Committee commissioned an externally facilitated evaluation of Board members from Mr Sean O'Connor (who is wholly independent of Mears and has carried out evaluations for other listed companies). This was done in addition to the regular appraisal process noted in the Corporate Governance Report. The evaluator interviewed each Board member and also contacted external advisers. No major issues were identified but a number of action points were noted and are now being addressed. We have adopted a policy that such externally facilitated evaluations will be undertaken at least every three years.

The Board acknowledges that diversity extends beyond the boardroom and supports the management effort to build a diverse organisation. The Company believes in promoting diversity at all levels of the organisation; at present 20% of our senior managers are female. The Board is confident that this will increase over time. When considering the optimum composition of the Board, the benefits of diversity are appropriately balanced with their skills, knowledge, experience and approach.

# Report of the Audit Committee

## Introduction

**The Committee has clearly defined terms of reference adopted by the Board and which set out its objectives and responsibilities relating to financial reporting, internal controls, risk management and the application of appropriate accounting policies and procedures.**

In recent years a considerable focus has been placed on risk governance and the effectiveness of management oversight of both risk and internal controls. In the early part of 2014, the Audit Committee and management commissioned an external review of both areas which recognised the excellent work undertaken and made some recommendations to assist management with strengthening and enhancing the risk management and internal audit function.

The Audit Committee has oversight responsibility for the internal audit function and approved the internal audit programme. We have reviewed and updated the Group's risk register. The senior management teams play a central role in reviewing and challenging the Group's risks. The Group risk team presented risk management training modules to all levels of the management development programme to further increase our strong risk management ethos.

During 2014, we engaged KPMG as our outsourced internal audit partner, which completed a detailed audit programme on the Group's financial risks. Some improvements were proposed but overall the control environment was generally considered to be effective and processes currently in place are designed effectively to prevent or detect material errors or fraud from occurring.

We continue to review the external audit engagement on an annual basis having carried out a tender exercise in 2013. The tender process resulted in the re-appointment of Grant Thornton UK LLP and I am delighted that it has brought additional innovation and added value to the process.

**D Marston**
**Audit Committee Chairman**
davida.marston@mearsgroup.co.uk
17 March 2015

## Role of the Committee

The Committee has access to the financial expertise of the Group and its auditor and can seek further professional advice at the expense of the Group, if required.

The Audit Committee is responsible for:

- reviewing and recommending for approval by the Board the annual and interim financial statements;
- agreeing the scope and reviewing the results of the external audit and the setting of the auditor's remuneration;
- reviewing the effectiveness of the Group's internal controls and risk management processes;
- approving the internal audit plan and monitoring the effectiveness of the internal audit function; and
- reviewing the 'whistleblowing policy' by which employees and other stakeholders may raise concerns regarding potential impropriety in confidence and ensure that these concerns are investigated appropriately.

The Committee's terms of reference are available on the Company's website and on request from the Company Secretary.

The Committee is comprised of financially literate members with the requisite ability and experience to enable the Committee to discharge its responsibilities. Two of the three members are considered as having recent relevant financial experience.

## Committee meetings

The Committee met four times during the year with attendance by all members. These meetings were also attended by the Group Chief Executive Officer, the Group Finance Director and the Chief Risk Officer as required. The external auditor, Grant Thornton UK LLP, was invited to all meetings. There was also significant dialogue outside formal meetings between Committee members, Executive Directors and the external auditor particularly during the audit process and the preparation of the Annual Report. The Audit Committee Chairman meets with the external auditor regularly throughout the year.

## Main activities of the Committee during the year

### Financial reporting

The primary role of the Committee in relation to financial reporting is to review with both management and the external auditor the appropriateness of the half-year and annual financial statements, concentrating upon the reasonableness of the accounting policies, adherence to accounting standards and sufficiency and clarity of the information disclosed.

The primary areas of judgement considered by the Committee in relation to the 2014 accounts, and how these were addressed, were:

#### Impairment of goodwill

For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows; these are termed as cash-generating units (CGUs). Mears has identified two CGUs, being Social Housing and Care. Determining whether goodwill is impaired requires an estimate of the value in use of each of the CGUs to which goodwill has been allocated. The value-in-use calculation involves an estimate of the future cash flows of the CGU and also the selection of an appropriate discount rate to calculate present values. Future cash flows are estimated using the current one-year budget, extrapolated for five years using specific rates with a general terminal growth rate being used thereafter. Estimated growth rates over each period are based on past experience and knowledge of the individual sector's markets. The Directors consider that the estimates and judgements involved in determining the value in use of the Care CGU goodwill are the most significant to the Group and they have therefore utilised the services of an external consultant to assist with this impairment review. The value in use is most sensitive to changes in the terminal growth rate, the explicit growth rate during the forecast period and the discount rate. The sensitivity to changes in these estimations is detailed in note 11.

The Audit Committee addressed this area of judgement in the following ways the Committee reviewed the key assumptions proposed by management, notably forecast growth rate and discount rate. Given the importance of these two assumptions, the Committee reviewed reports prepared by a third party valuation expert, American Appraisal, which provided validation to the management proposals:

- the Committee reviewed the asset valuation report prepared by American Appraisal on behalf of management. The Committee gave particular focus to the sensitivity analysis which showed the level of changes in key assumptions that would be required before triggering any impairment; and
- this area represented a prime area of audit focus and Grant Thornton UK LLP provided detailed feedback to the Committee.

#### Defined benefit liabilities

A number of key estimates have been made, which are given below and which are largely dependent on factors outside the control of the Group:

- inflation rates;
- mortality;
- discount rate; and
- salary and pension increases.

Details of the particular estimates used are included in the pensions note.

Where the Group has a contractual right to recover the costs of making good any deficit pension scheme, the fair value of that asset has been recognised and disclosed. The right to recover costs is limited to exclude situations where the Group causes the scheme to incur service costs in excess of those which would have been incurred were the members employed within Local Government. The Directors have made judgements in respect of whether any of the deficit is as a result of such situations.

The right to recover costs is also limited to situations where the cap on employer contributions to be suffered by the Group is not set so as to contribute to reducing the deficit in the scheme. The Directors, in conjunction with the scheme actuaries, have made judgements in respect of the predicted future service cost and contributions to the scheme to reflect this in the fair value of the asset recognised.

The Audit Committee addressed this area of judgement in the following ways:

- the Committee reviewed the key assumptions proposed by management, notably assumptions in respect of discount rate, RPI, CPI and future salary increases. Given the materiality of this area, the Committee reviewed a report prepared by Ernst and Young LLP which validated the assumptions set by management and provided a comparison with other quoted companies; and
- given the technical nature of this area, the Committee placed reliance upon the actuarial reports prepared by the respective scheme actuaries in respect of each of the defined benefit pension schemes.

# Report of the Audit Committee continued

## Main activities of the Committee during the year continued

**Financial reporting** continued

Revenue recognition

Revenue is recognised when the outcome of a job or contract can be estimated reliably; revenue associated with the transaction is recognised by reference to the stage of completion of work at the balance sheet date. The outcome of the transaction is deemed to be able to be estimated reliably when all the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity;
- the stage of completion of the transaction at the balance sheet date can be measured reliably; and
- the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Full provision is made for losses on all contracts in the year in which the loss is first foreseen.

The Audit Committee addressed this area of judgement in the following ways:

- the Committee reviewed the key judgements report prepared by management which provided a detailed explanation in respect of the valuation of unbilled works and the recognition of revenues;
- the Committee took comfort from the contract management system which is central in generating the valuation of works (both billed and unbilled) and the integrated process that is followed to ensure an accurate cut-off to that revenue is appropriately matched to cost. Grant Thornton tested these systems during its audit fieldwork and provided feedback to the Committee on this crucial area; and
- this area represented a prime area of external audit focus. Grant Thornton UK LLP carried out both controls based and substantive testing of the amounts recoverable on contracts, adopting a risk based approach to sampling and provided detailed feedback to the Committee in this area.

### Internal control and risk management

The UK Corporate Governance Code requires that the Directors review the effectiveness of the Group's system of internal control. This extends the Directors' review to cover all material controls, including operational, compliance and financial controls and risk management systems. The Directors are satisfied that procedures are in place to ensure that the Group complies with the Turnbull Committee guidance published by the Institute of Chartered Accountants in England and Wales and that the procedures have been applied during the year.

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. The Board has delegated some of these responsibilities to the Audit Committee which has reviewed the effectiveness of the system of internal control and ensured that any remedial action has been or is being taken on any identified weaknesses. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, but not absolute, assurance against material misstatement or loss. It includes all controls including financial, operational and compliance controls and risk management procedures.

The Board confirms that the Group has in place an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. The Group endeavours to ensure that the appropriate controls, systems and training are in place and has established procedures for all business units to operate appropriate and effective risk management.

The processes used to assess the effectiveness of the internal control systems are ongoing, allowing a cumulative assessment to be made, and include the following:

- delegation of day-to-day management to operational management within clearly defined systems of control, including:
  - the identification of levels of authority within clearly identified organisational reporting structures;
  - the identification and appraisal of financial risks both formally, within the annual process of preparing business plans and budgets, and informally, through close monitoring of operations;
  - a comprehensive financial reporting system within which actual results are compared with approved budgets, quarterly re-forecasts and previous years' figures on a monthly basis and reviewed at both local and Group level; and
  - an investment evaluation procedure to ensure an appropriate level of approval for all capital and revenue expenditure;
- discussion and approval by the Board of the Group's strategic directions, plans and objectives and the risks to achieving them, combined with regular reviews by management of the risks to achieving objectives and actions being taken to mitigate them;
- review and approval by the Board of annual budgets, combined with regular operational and financial reviews of performance against budget, prior year results and regular forecasts by management and the Board;
- regular reviews by the Board and Audit Committee of identified fraudulent activity and actions being taken to remedy any control weaknesses;
- regular reviews by management and the Audit Committee of the scope and results of internal and external audit work across the Group and the implementation of recommendations; and
- consideration by the Board and by the Audit Committee of the major risks facing the Group and of the procedures in place to manage them and to ensure controls react to changes in the Group's overall risk profile. These include health and safety, people, legal compliance, quality assurance, insurance and security and reputational, social, ethical and environmental risks.

## Main activities of the Committee during the year continued

### Internal control and risk management continued

The Board has reviewed these procedures and considers them appropriate given the nature of the Group's operations. The system of internal control and risk management is embedded into the operations of the Group and the actions taken to mitigate any weaknesses are carefully monitored.

The key controls in place are:

- a defined organisational structure and an appropriate level of delegated responsibility to operational management;
- authorisation limits for financial and non-financial transactions;
- written operational procedures;
- a robust system of financial budgeting and forecasting;
- a robust system of financial reporting with actual results compared to budget and forecast results; and
- a regular reporting of operational performance and risks to the Board.

At the end of 2013 and running into the early part of 2014, the Audit Committee commissioned an independent review of internal audit and our risk management to provide guidance as to the strengths and weaknesses of the function and also identify and recommend changes and pragmatic action plans to improve its effectiveness. Grant Thornton was appointed to carry out this review and utilise its first-hand knowledge from working with the internal audit functions of groups of various sizes operating in a diverse range of markets. The Group's internal audit function was benchmarked on a range of KPIs to identify where performance could be improved. The review considered issues including audit planning and delivery methodologies, the capabilities of the team and the outputs provided to management and the Board.

The Company has in place internal control and risk management systems in relation to the Company's financial reporting process and the Group's process for the preparation of consolidated accounts. The consolidated financial statements are produced by the Group finance function, which is responsible for the review and compilation of reports and financial results from each of the operating subsidiaries in accordance with the Group reporting procedures. The consolidated financial statements are supported by detailed working papers. The Audit Committee is responsible for overseeing and monitoring these processes, which are designed to ensure that the Company complies with relevant regulatory reporting and filing provisions. As at the end of the period covered by this report, the Audit Committee, with the participation of the Chief Executive Officer and Finance Director, evaluated the effectiveness of the design and operation of disclosure controls and procedures designed to ensure that information required to be disclosed in financial reports is recorded, processed, summarised and reported within specified time periods.

The Committee carried out a review of its effectiveness with input from Committee and Board members, management and the external auditor. The review concluded that the Audit Committee members had sufficient expertise and committed time to discharge their responsibilities.

Additionally, in line with the UK Corporate Governance Code, the Group has arranged appropriate insurance cover in respect of legal action against its Directors.

### External audit related services

The Committee is also responsible for monitoring and reviewing the performance, independence and objectivity of Grant Thornton, the external auditor. The external auditor has also confirmed that it has complied with relevant UK independence standards.

The services provided by Grant Thornton are currently restricted to audit related and corporation tax compliance. This restriction on the provision of non-audit services enables the Committee to be satisfied that Grant Thornton's objectivity and independence as auditor has not been impaired.

The fees paid to Grant Thornton during the year in respect of non-audit services were £0.05m (2013: £0.08m). The total fees for non-audit services represented approximately 14% of the audit fees paid for the year (2013: 22%).

Read more in the financial statements on **pages 71 to 131**

# Report of the Remuneration Committee

## Dear shareholder,

**I am pleased to introduce the Mears 2014 Remuneration Report.**

**The Directors' Remuneration Policy Report sets out the Company's remuneration policy for Directors.**

This policy was subject to a binding shareholder vote at the 2014 AGM and will remain unchanged for a period of at least three years. For completeness, the policy is detailed in full within this Annual Report.

The Annual Report on Remuneration sets out payments and awards made to the Directors and details the link between Company performance and remuneration for the 2014 financial year. This report together with this letter is subject to an advisory shareholder vote at the 2015 AGM.

The Company's remuneration structure has been designed to support the evolving business strategy and foster a pay for performance culture helping us achieve our corporate goals. The success of the Company is driven by a continued focus to drive shareholder value through:

- growing revenues and earnings in a sustainable and profitable manner;
- a progressive dividend policy closely tracking growth in earnings;
- generating strong level of cash flow to deliver returns for shareholders and investment for future growth; and
- efficient and targeted investment of cash.

These measures together with shareholder returns are captured in the cornerstone of our remuneration structure, namely the Management Incentive Plan (MIP). The MIP, together with the new shareholding guidelines, which we are introducing this year, also ensures that the interests of Executives continue to be aligned with those of shareholders over the longer term.

During the last twelve months the Company has continued to grow earnings and generate cash flow at a profitable level despite the challenging economic environment. This is reflected in the performance against the MIP targets for 2014 as follows:

| Performance measures* | Target | Maximum | Actual |
|---|---|---|---|
| EPS growth | 10% | 15% | 11.5% |
| TSR growth | 10% | 15% | (17.1)% |
| Cash conversion (underpin) | 80% | | 107.2% |
| ROCE (underpin) | 10% | | 18.2% |

* See pages 59 and 60 for definitions of performance measures and actual remuneration outcomes.

To reflect the shareholder outcomes over the last year, the Committee has decided that the MIP contribution for 2014 will be made entirely in shares with no cash element being released to the Executive Directors. This will serve to further align their interests with those of shareholders and focus them on delivering strong performance in the coming year.

The Committee was disappointed that a significant number of votes were cast against the 2013 Directors' Remuneration Report. We are committed to building investor confidence with regard to our Executive remuneration arrangements and so have carefully considered the issues raised by shareholders and proxy voting agencies. In response, we have sought to clarify the operation of our remuneration policy with respect to the aspects noted below, and having particular regard to revisions to the UK Corporate Governance Code:

- MIP contributions – in 2014, contributions for on-target performance were set at 20% of the maximum, down from 70% in 2013, in response to the views of shareholders and proxy voting agencies. This approach will apply for 2015 and onwards.
- Performance metrics will be set annually by reference to internal budgets and market expectations. In the challenging

# Remuneration report

economic and political environment in which the Company currently finds itself this may mean that targets change year on year. Maximum payout of the MIP contribution will, however, only be earned for exceptional performance. The performance targets for the 2015 MIP cycle are disclosed on page 62 of the remuneration report.

- Shareholding requirement – the Remuneration Committee has formalised the shareholding requirement at a level of 200% of salary for each of our Executive Directors, to be built up over a five-year period. This ensures that the interests of Executives are aligned with shareholders over the longer term.
- Share Plan – the Remuneration Committee has removed the discretion to grant existing Executive Directors share awards and this has accordingly been removed from our remuneration policy table.
- Malus/clawback – 50% of the accumulated plan account in the first four years of operation is subject to forfeiture if a minimum level of performance is not maintained. The Committee believes that this is a more stringent provision than current best practice guidelines, which allow for malus enactment only in exceptional circumstances, e.g. material misstatement/gross misconduct.

The Committee also believes that the five-year length of the MIP cycle (resulting in a longer period over which performance is assessed compared to the current market standard of three years) and implicit holding periods present through deferral of MIP payments over the cycle provide sufficient protection to shareholder interests without implementing additional clawback provisions to apply after a pre-defined period.

Looking to 2015 and beyond, the Remuneration Committee is aware that given the rapid growth in the size of the business over the last couple of years, combined with our disciplined and conservative approach to remuneration, levels of pay fall significantly short of market norms. The Executive Directors are in the lower quartile against a comparator group of 20 quoted companies with similar corporate attributes to Mears when we assess their remuneration (especially fixed remuneration which of course drives total remuneration levels). I am confident that our Executives will continue to work conscientiously to deliver the business strategy but believe that it is in the best interests of all stakeholders to address this shortfall over the next couple of years.

For 2015, the Committee has therefore increased base pay for the Executive Directors by 10% and will consider similar increases over the next two years, contingent on corporate and individual performance, to ensure that an exceptional management team are paid fairly for their efforts. Furthermore, this is the first pay increase that the Executive Directors have received for three years and is also justified by the significant experience of the executive team and performance in role from appointment. It is important to note that there will be no change to the actual remuneration structure as the Committee firmly believes that the unique nature of the MIP is the optimal incentive mechanism to focus an exceptional management team on sustaining strong year on year performance against those corporate metrics which drive long-term shareholder value.

I hope that you find the information in this report helpful and I look forward to your support in the forthcoming AGM. I am always happy to hear from the Company's shareholders and you can contact me direct, or via the Company Secretary, Ben Westran, if you have any questions on this report or more generally in relation to the Company's remuneration.

**P F Dicks**
**Remuneration Committee Chairman**
peter.dicks@mearsgroup.co.uk
17 March 2015

## Directors' remuneration policy

### Remuneration policy and philosophy

| Remuneration policy | How is this achieved? |
|---|---|
| Levels of remuneration should be appropriate to retain and motivate the Executive talent required to meet the Group's objectives. | • By providing a threshold level of remuneration which reflects the individual's experience, role and contribution within the Group.<br>• Remuneration levels are reviewed annually with due consideration afforded to Mears' remuneration policy and external benchmarks and market practices. |
| Incentive arrangements for key individuals should be capable of providing exceptional levels of total payment if outstanding performance is achieved. | • The Executive Directors' remuneration packages are designed to ensure that variable components of an Executive Director's total remuneration package amounts to around one third for target performance and around two thirds for stretching performance. |
| The significant component of each Executive's total compensation should be delivered through performance related pay. | • At stretching performance, around two thirds of the Executive Directors' total remuneration package is based on performance related pay. |
| There should be a commitment to fostering a strong performance culture that aligns an individual's rewards with the key corporate metrics that drive shareholder value creation. | • Performance targets are set which are motivating and directly aligned to the Group's strategic underlying performance.<br>• The Committee also ensures that the remuneration package does not lead to irresponsible behaviour and that it takes appropriate account of risk. |

# **Remuneration report** continued

## **Directors' remuneration policy** continued

### Executive Directors

The table below sets out the key elements of the policy for Executive Directors:

| Objective and link to strategy | Operation | Maximum opportunity | Performance measures and assessment |
|---|---|---|---|
| **Base salary** | | | |
| The purpose of the base salary is to:<br>• help recruit and retain key individuals;<br>• reflect the individual's experience, role and contribution within the Group; and<br>• ensure fair reward for 'doing the job'. | The Committee reviews base salaries annually in April in order to ensure that Executive Directors remain competitively aligned with external market rates.<br>The Committee will retain the discretion to increase an individual's salary where there is a significant difference between current levels and a market competitive rate. However, in determining whether to increase levels the Committee will take the following into consideration:<br>• the performance of the individual Executive Director;<br>• the individual Executive Director's experience and responsibilities;<br>• the impact on fixed costs of any increase; and<br>• pay and conditions throughout the Group.<br>When setting the salary levels for the Executive Directors, in addition to the factors summarised above, salary levels paid by a number of comparator companies of a similar size to Mears are taken into account. | The Committee's policy is to set base salary at an appropriate level taking into account the factors outlined in this table. | Not applicable. |
| **Other benefits** | | | |
| To provide benefits that are valued by the recipient and are appropriately competitive. | The Executive Directors receive additional benefits including a company provided car or an allowance in lieu, life assurance and private medical insurance. Benefits-in-kind are not pensionable. | Benefit values vary year on year depending on premiums and the maximum potential value is the cost of these provisions. | Not applicable. |
| **Management Incentive Plan (MIP)** | | | |
| The MIP provides a strong link between reward and corporate performance in order to appropriately retain and motivate the Executive Directors and senior management who are critical to executing the business strategy.<br>Align the interests of Executive Directors and senior management more closely with shareholders over the longer term and provide a greater exposure to share price movements over this period. | • Participants have a plan account into which contributions by Mears are made.<br>• Performance is measured by reference to targets over the financial year.<br>• Contributions are made annually with payments made each year to ensure an overlap with the next plan year depending on the extent to which the performance conditions are met.<br>• After contributions are made, 50% of the plan balance is paid in cash and 50% is deferred in shares. However, at the discretion of the Remuneration Committee, the element to be deferred can be increased from 50% but never decreased.<br>• No contribution is made to a participant's plan account unless the performance conditions and financial underpins set at the beginning of the relevant year are satisfied. Where only one of the financial underpins is met and the performance conditions are met then the annual contribution will be reduced by 50%.<br>• 50% of the plan account is at risk of forfeiture each year if minimum level of performance is not met.<br>• Further details of the operation of the MIP including the performance conditions for 2015 are set out on pages 58, 59 and 62. | Annual contributions made to Executive Directors will be capped at a maximum of 250% of salary.<br>Target payments will be at 20% of an Executive Director's maximum opportunity. | Contributions will be based on the satisfaction of performance conditions, for example EPS and TSR. The Remuneration Committee has discretion to set performance measures and weightings on an annual basis, with performance conditions for the next financial year set out in the Statement of Implementation on pages 62 to 63. |

## **Directors' remuneration policy** continued

### **Executive Directors** continued

| Objective and link to strategy | Operation | Maximum opportunity | Performance measures and assessment |
|---|---|---|---|
| **Pension** | | | |
| To provide a framework to save for retirement that is appropriately competitive. | All Executive Directors receive a contribution into their respective defined contribution plans, which are subject to periodic review to ensure that they remain in line with rates applicable in the market. Only the base salary is pensionable. | The Executive Directors receive a contribution of 15% of salary. R Holt receives a contribution of 30% of salary. | Not applicable. |
| **All employee share plan** | | | |
| Encourages employees to own shares in order to increase alignment over the longer term. | Under the terms of the Sharesave Plan all employees can apply for three or five-year options to acquire the Company's shares priced at a discount of up to 20%. | £500 per month over a three-year or five-year period. | Not applicable. |
| **Shareholding requirement (new for 2015)** | | | |
| Ensures a long-term locked-in alignment between the Executive Directors and shareholders, ensuring that they build up and maintain a minimum level of shareholding throughout their employment with the Company. | The shareholding requirement, which has been formalised by the Remuneration Committee for the first time this year, will operate in the following manner:<br>• only shares unconditionally owned by the Executive Director will count against the requirement; and<br>• shares can be built up over a five year period from implementation of the policy through the vesting and retention of share awards and/or MIP payments. | Minimum shareholding requirement is 200% of salary. | Not applicable. |
| **Provisions of previous policy that will continue to apply** | | | |
| Other Non-Executive appointments. | Executive Directors have an obligation to inform the Board, specifically the Remuneration Committee, of any Non-Executive positions held or being contemplated and of the associated remuneration package. The Remuneration Committee will consider the merits of each case and carefully consider the work and time commitment required to fulfil the Non-Executive duties and the potential benefit to the Group and then determine whether the remuneration should be retained by the Executive or passed over to the Group. | Not applicable. | Not applicable. |

# **Remuneration report** continued

## **Directors' remuneration policy** continued

### Notes to the future policy table

Reasons for selecting performance targets

The Committee believes that the EPS growth performance condition for the MIP is directly aligned to the Company's strategic objectives over the long term and is also transparent, fully understood by participants and is an externally audited metric over which they have line of sight. Total shareholder return has been selected as a performance condition for the MIP as it provides an unbiased indicator of value created for shareholders and creates a strong link with executive reward. Targets are set on a sliding scale based on internal growth expectations of the Company and market forecasts. Maximum targets are believed to incorporate an appropriate amount of stretch which would reflect excellent performance in current market conditions. Two financial underpins, based on threshold levels of cash conversion and return on capital employed, have also been set which impact the level of contribution under the EPS performance condition. Given that no contribution will be made in respect of the EPS condition unless these underpins are achieved, this ensures that the quality of earnings is protected and overall corporate performance is strong before a contribution to the plan accounts is made.

Where there are multiple underpins, failure to achieve one of the underpins will result in a reduction of the annual contribution by a relevant proportion. For example, if there are two underpins and one is not met then the annual contribution will be reduced by 50%. If both underpins are not met then there will be no annual contribution.

### Changes to remuneration policy from previous policy

The Remuneration Committee would like to clarify the operation of the following aspects of the policy:

*Management Incentive Plan (MIP)* – The Remuneration Committee would like to clarify that target payments under the MIP will be at 20% of an Executive Director's maximum opportunity, as for the assessment of MIP contributions in 2014 (rather than 70% as previously disclosed).

*Shareholding requirement* – It has been previously communicated that Executive Directors would be required to build up a meaningful stake in the Company. The Remuneration Committee has hence formalised the operation of the shareholding requirement as disclosed in the policy table.

*Share Plan* – The Remuneration Committee has removed the discretion to grant existing Executive Directors share awards under this plan.

### Differences in remuneration policy for all employees

The remuneration policy for the Executive Directors is now more heavily weighted towards variable pay than for other employees with a large proportion of their overall package dependent on successful and sustained execution of the business strategy over the longer term. The objective of such a policy is to create a strong link between pay for Executive Directors and the value created for shareholders.

### Committee discretions

The Committee will operate the MIP and Share Plan according to their respective rules. The Committee retains discretion, consistent with market practice, in a number of regards to the operation and administration of these plans. These include, but are not limited to, the following in relation to the MIP and Share Plan:

- the participants;
- the timing of grant of an award;
- the size of an award;
- the determination of vesting;
- discretion required when dealing with a change of control or restructuring of the Group;
- determination of the treatment of leavers based on the rules of the plan and the appropriate treatment chosen;
- adjustments required in certain circumstances (e.g. rights issues, corporate restructuring events and special dividends); and
- the annual review of performance measures and weighting for the MIP and exercise conditions (if any) for the Share Plan.

These discretions, which in certain circumstances can be operated in both an upward and downward manner, are consistent with market practice and are deemed necessary for the proper and fair operation of the schemes in order to achieve their original purpose. It is the Committee's policy, however, that there should be no element of reward for failure and any upward discretion will only be applied in exceptional circumstances.

## Directors’ remuneration policy continued

### Non-Executive Directors

The remuneration of the Non-Executive Directors is set at a level sufficient to attract individuals with appropriate knowledge and experience. It is determined by the Board and is within the limits set by the Articles of Association. Assistance is also available from the Group’s remuneration advisers. No additional fees are paid for Committee membership or other normal duties and Non-Executive Directors do not participate in any incentive, pension or bonus arrangements. Current fee levels are set out in the statement of implementation of remuneration policy on page 63.

### Approach to recruitment remuneration

In the event that the Company recruits a new Executive Director (either from within the organisation or externally), when determining appropriate remuneration arrangements, the Committee will take into consideration all relevant factors (including but not limited to quantum, the type of remuneration being offered and the jurisdiction the candidate was recruited from) to ensure that arrangements are in the best interests of both the Company and its shareholders without paying more than is necessary to recruit an Executive of the required calibre.

The Committee would generally seek to align the remuneration of any new Executive Director following the same principles as for the current Executive Directors (set out in the table on page 51).

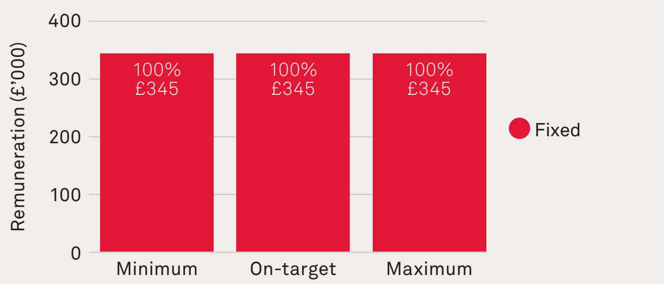
The elements that would be considered by the Company for inclusion in the remuneration package for a new Director are in line with those offered to existing Directors (see policy table on pages 52 and 53 for more details):

- salary and benefits including defined contribution pension participation or a salary supplement in lieu of pension provision;
- participation in MIP of up to 250% of salary;
- in certain circumstances, participation in the Share Plan of up to 200% of salary and all employee share plans operating at that time; and
- costs relating to but not limited to relocation, legal, financial, tax and visa advice and pre-employment medical checks.

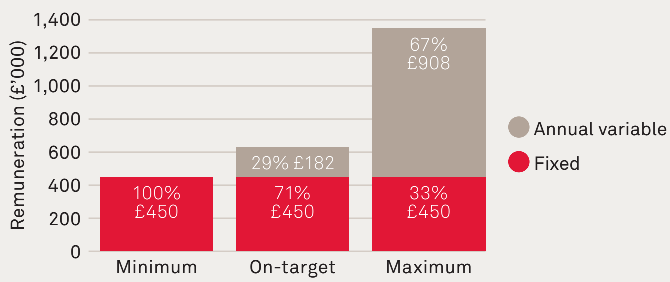
The Committee may make awards on appointing an Executive Director to ‘buy out’ remuneration arrangements forfeited on leaving a previous employer. The Committee would take into account both market practice and any relevant commercial factors in considering whether any enhanced and/or ‘one-off’ annual incentive or long-term incentive award was necessary. Awards made by way of compensation for forfeited awards would be made on a comparable basis, taking account of performance achieved (or likely to be achieved), the proportion of the performance period remaining and the form of the award. Compensation could be in cash or shares.

The Committee’s policy is for all Executive Directors to have rolling service contracts with a notice period of twelve months, unless on an exceptional basis to complete an external recruitment successfully, when a longer initial period reducing to twelve months may be used.

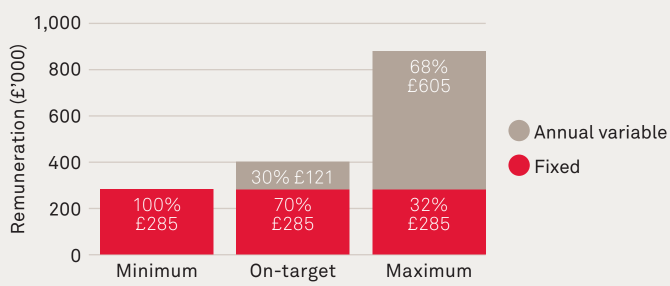
**R Holt**



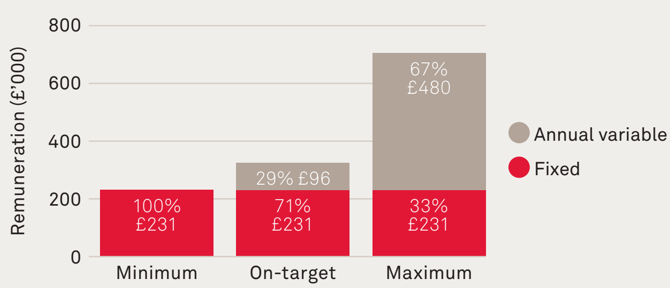

**D J Miles**




**A C M Smith**




**A Long**



# **Remuneration report** continued

## **Directors' remuneration policy** continued

### Service contracts and payment for loss of office

| Director | Date of contract/ letter of appointment | Notice period by Company or Director |
|---|---|---|
| **Executive** | | |
| R Holt | June 2008 | 6 months |
| D J Miles | June 2008 | 12 months |
| A C M Smith | June 2008 | 12 months |
| A Long | August 2009 | 12 months |
| **Non-Executive** | | |
| D L Hosein | June 2008 | Rolling 6-month appointment |
| M G Rogers | June 2008 | Rolling 6-month appointment |
| P F Dicks | June 2008 | Rolling 6-month appointment |
| D Marston | June 2010 | Rolling 6-month appointment |
| R Macnamara | June 2010 | Rolling 6-month appointment |

All Executive Directors' contracts are rolling and, therefore, will continue unless terminated by written notice. In the event of the termination of an Executive Director's contract, salary and benefits will be payable during the notice period. There will, however, be no automatic entitlement to bonus payments or share incentive grants during the period of notice.

The rules of the MIP and Share Plan set out what happens to awards if a participant ceases to be an employee or Director of Mears before the end of the vesting period. Generally, any outstanding share awards will lapse on such cessation, except in certain circumstances.

If the Executive Director ceases to be an employee or Director as a result of death, injury, ill health, redundancy, retirement, the sale of the business or company that employs the individual or any other reason at the discretion of the Committee, then they will be treated as a 'good leaver' under the plan rules.

Under the MIP, a good leaver's accumulated plan account (as measured at the date of cessation of employment) will be paid to them. The Committee has discretion to determine the amount, if any, of any contribution to be made to their plan account in the year of cessation which will then be pro-rated by the time elapsed from the start of the year to the date of cessation. This amount would then be paid to the participant.

On a change of control, the accumulated plan accounts of all participants (as measured at the date of change of control) will be paid to them.

Under the Share Plan, a proportion of a good leaver's award will vest on cessation of employment by reference to the time elapsed from grant to cessation. The Committee has discretion to determine the period during which the good leaver may exercise their award after cessation.

On a change of control, all awards under the Share Plan will vest immediately.

### Illustrations of application of remuneration policy

We estimate that the level of remuneration received by each Executive Director for the first full year in which the policy applies will be, indicatively, at three different levels of performance:

- minimum performance is where only fixed pay (salary, benefits and pension) is payable and no performance related pay accrues;
- on-target performance is the level of performance required to deliver 20% of the maximum annual contribution to the MIP; and
- maximum performance would result in the maximum annual bonus contribution to the MIP.

Fixed salary is base salary for 2015 plus the value of pension and other benefits.

The charts on page 55 demonstrate the balance between fixed and variable pay for minimum, on-target and maximum performance for Executive Directors' remuneration in 2015 in line with the relevant policy.

### Consideration of employment conditions elsewhere in the Company in developing policy

The Company sets terms and conditions for employees which reflect the different legislative and labour market conditions that operate in each of our jurisdictions. We will always meet or exceed national minimum standards for terms and conditions of employment in each of our business areas. Pay arrangements in our businesses also reflect local performance with personal increases based on achievement, individually assessed. Mears believes in the value of continuous improvement, both for the individual and for the Company. The Company did not consult with employees in drawing up the Directors' remuneration policy.

When determining the remuneration of Executive Directors, the Remuneration Committee takes into account business unit performance, including both financial performance and safety improvements in the year. Due to the wide variety of labour market conditions and the markets in which we operate, pay rates are not normally considered when considering Executive Director base pay reviews.

The Remuneration Committee reviews and notes the salaries of Senior Executives within the Group. Share awards and bonus plans are cascaded down below Executive level to senior management, aligning the Senior Management Team to deliver value for the Group.

### Consideration of shareholder views

The Committee is committed to an ongoing dialogue with shareholders and seeks shareholder views when any significant changes are being made to remuneration arrangements. We remain sensitive to the views of shareholders and sought to consult many of our largest shareholders during the changes we made to the remuneration structure in 2013.

## Directors' remuneration policy continued

### Consideration of shareholder views continued

The Committee was disappointed with the number of votes against our 2013 Directors' Remuneration Report and listened closely to the views of our major shareholders and proxy voting agencies to understand the reasons why. Our response to specific views included the removal of the Share Plan from our policy (with no further awards being granted to the existing Executive Directors under this plan) and reduction in MIP contributions for on-target performance, together with other clarifications to policy (see the Annual Statement for more details) and the introduction of formal shareholding guidelines.

The Company will continue to monitor shareholder comments and retain an open dialogue as necessary.

## Annual report on remuneration

This section of the Remuneration Report contains details of how the Company's remuneration policy for Directors was implemented during the financial year.

### Single total figure of remuneration (audited)

Executive Directors

The remuneration of Executive Directors showing the breakdown between elements and comparative figures is shown below. Figures provided have been calculated in accordance with the Regulations.

| Executive Director (£'000) | Year | Salary | Taxable benefits | Annual incentives | Pension | Total |
|---|---|---|---|---|---|---|
| R Holt | 2014 | 250 | 20 | — | 75 | 345 |
| | 2013 | 250 | 20 | — | 75 | 345 |
| D J Miles | 2014 | 330 | 32 | — | 50 | 412 |
| | 2013 | 330 | 32 | 413 | 50 | 825 |
| A C M Smith | 2014 | 220 | 6 | — | 33 | 259 |
| | 2013 | 220 | 6 | 275 | 33 | 534 |
| A Long | 2014 | 180 | 11 | — | 27 | 218 |
| | 2013 | 180 | 12 | 225 | 27 | 444 |

Non-Executive Directors

The remuneration of Non-Executive Directors showing the breakdown between elements and comparative figures is shown below. Figures provided have been calculated in accordance with the Regulations.

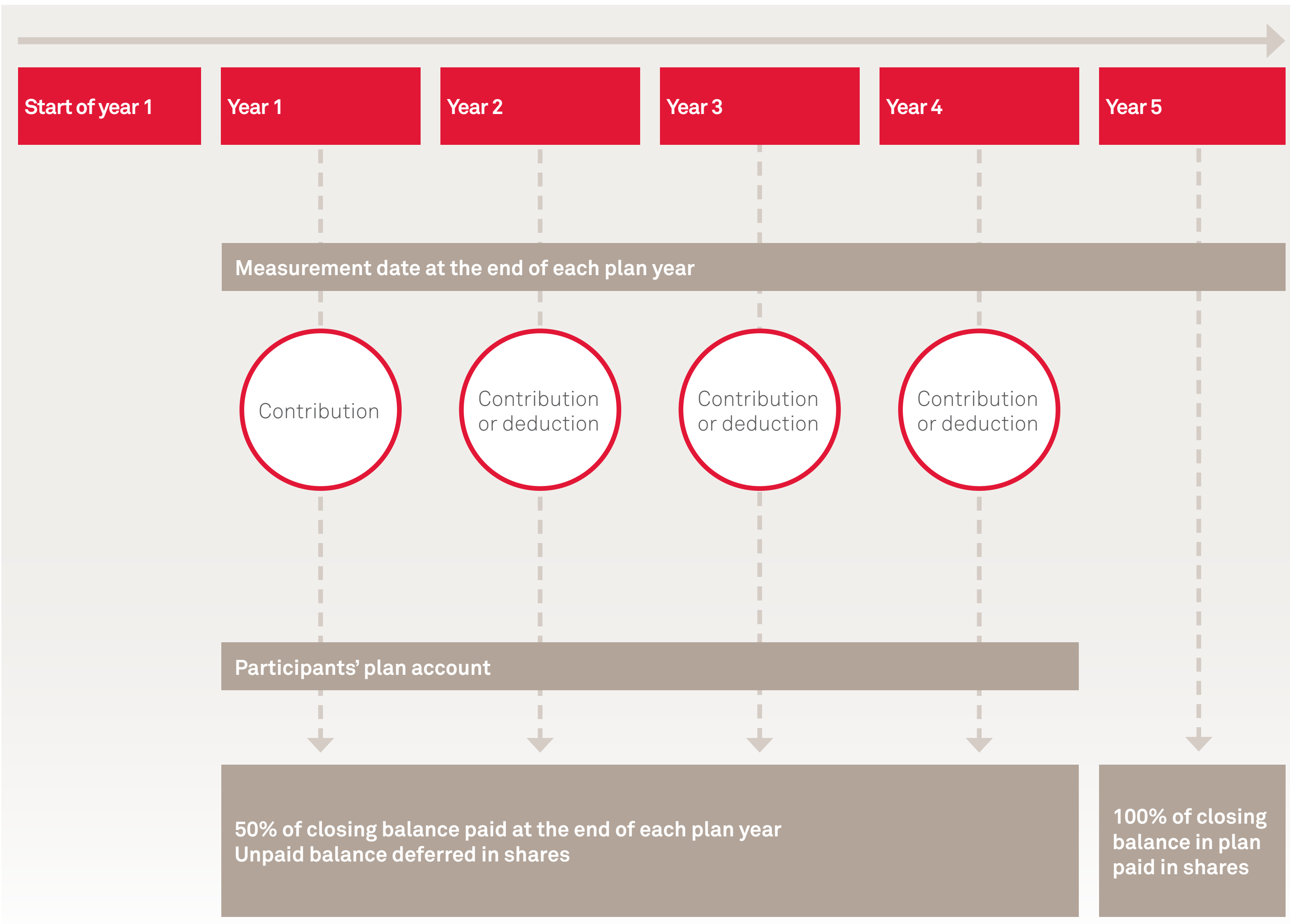
| Non-Executive Director (£'000) | Year | Basic fees | Additional fees | Other | Total fees |
|---|---|---|---|---|---|
| D L Hosein | 2014 | 45 | — | — | 45 |
| | 2013 | 45 | — | — | 45 |
| M G Rogers | 2014 | 45 | — | 1 | 46 |
| | 2013 | 45 | — | 2 | 47 |
| P F Dicks | 2014 | 45 | — | — | 45 |
| | 2013 | 45 | — | — | 45 |
| D Marston | 2014 | 45 | — | — | 45 |
| | 2013 | 45 | — | — | 45 |
| R Macnamara | 2014 | 45 | — | — | 45 |
| | 2013 | 45 | — | — | 45 |

# Remuneration report continued

## Annual report on remuneration continued

**Additional details in respect of single total figure table (audited)**

The outcome of the MIP for the year ended 31 December 2014, being year two on the schematic is set out on page 60. The following schematic illustrates the operation of one cycle of the MIP:



## **Annual report on remuneration** continued

The performance measures and targets for the MIP for the year ended 31 December 2014 are detailed below:

| Description | Weighting | Calculation | Targets |
|---|---|---|---|
| Earnings per share (EPS) | 80% | • Growth in diluted EPS. Diluted EPS is stated before exceptional costs, share-based payments and the costs relating to the MIP and amortisation of acquisition intangibles and is adjusted for a normalised tax charge from 1 January 2014 to 31 December 2014.<br>• Base figure of 29.60p to be used. | • Threshold:<br>10% EPS growth leads to 20% maximum contribution.<br>• Maximum:<br>15% EPS growth leads to 100% maximum contribution.<br>• Straight-line contribution between 10% and 15% growth. |
| Absolute total shareholder return (TSR) | 20% | • Growth in absolute TSR from 1 January 2014 to 31 December 2014 (using an averaging period of 30 days for both dates).<br>• Starting share price = £4.58. | • Threshold:<br>10% TSR growth leads to 20% maximum contribution.<br>• Maximum:<br>15% TSR growth leads to 100% maximum contribution.<br>• Straight-line contribution between 10% and 15% growth. |
| Cash conversion (underpin) | N/A | • Cash inflow from operating activities as a proportion of operating profit before acquisition intangible amortisation measured at 31 December 2014. | • A threshold level of cash conversion of 80% must be achieved.<br>• If this threshold level is not achieved, 50% of any annual contribution will be forfeited. |
| Return on capital employed (ROCE) (underpin) | N/A | • Operating profit before acquisition intangible amortisation and exceptional costs/(total assets – current liabilities less all balances relating to bank borrowing and overdraft classified within non-current liabilities) at 31 December 2014. | • A threshold level of ROCE of 10% must be achieved.<br>• If this threshold level is not achieved, 50% of any annual contribution will be forfeited. |

# **Remuneration report** continued

## **Annual report on remuneration** continued

The actual performance achievement is summarised below:

| Performance measures | Actual | % of target satisfied |
|---|---|---|
| EPS growth | 11.5% | 44.3% |
| TSR growth | (17.1%) | 0% |
| Cash conversion (underpin) | 107% | Achieved |
| ROCE (underpin) | 18% | Achieved |

The Remuneration Committee was also satisfied that a minimum level of corporate performance had been exceeded and so no forfeiture of the accumulated plan accounts was necessary.

The resulting payments and unpaid balance deferred in shares are summarised below:

| | D J Miles | A C M Smith | A Long |
|---|---|---|---|
| 2013 closing balance brought forward (shares) | 90,065 | 60,043 | 49,126 |
| 2013 closing balance brought forward (£)* | 338,194 | 225,461 | 184,468 |
| 2014 contribution (£) | 292,490 | 194,994 | 159,540 |
| % of salary | 89% | 89% | 89% |
| 2014 cash element released | — | — | — |
| 2014 closing balance (deferred into shares) of participants' plan account (£) | 630,685 | 420,455 | 344,008 |
| Number of shares represented by closing balance** | 169,237 | 112,824 | 92,311 |

* Using share price as at 31 December 2014 = 375.5p.

** Using the average 30 day share price to 31 December 2014 = 372.7p.

### **Statement of Directors' shareholding and share interests (audited)**

Directors' share interests are set out below:

| Director | Number of beneficially owned shares | Share interests: Conditional unvested – Share awards/options | Share interests: Vested but unexercised – Options | Total interests held at year end |
|---|---|---|---|---|
| R Holt | — | — | 150,000 | 150,000 |
| D J Miles | 175,020 | 371,818 | 60,730 | 607,568 |
| A C M Smith | 110,000 | 247,878 | — | 357,878 |
| A Long | 36,230 | 202,809 | — | 239,039 |
| D L Hosein | — | — | — | — |
| M G Rogers | 50,000 | — | — | 50,000 |
| P F Dicks | 33,298 | — | — | 33,298 |
| D Marston | 15,342 | — | — | 15,342 |
| R Macnamara | 10,000 | — | — | 10,000 |

## Annual report on remuneration continued

**Statement of Directors' shareholding and share interests (audited)** continued

The following table sets out the details of the vested options exercised during the year:

| Date of grant | Type of award | Exercised during year | Exercise price of exercised options p | Market value of exercise p | Gain on exercise £* |
|---|---|---|---|---|---|
| **A C M Smith** | | | | | |
| 21 April 2006 | Approved | 10,000 | 300 | 493 | 19,300 |
| 21 April 2006 | Unapproved | 6,087 | 300 | 493 | 11,748 |
| 28 October 2009 | LTIP | 13,980 | 1 | 493 | 68,782 |
| 24 August 2010 | LTIP | 42,900 | 1 | 493 | 211,068 |
| **A Long** | | | | | |
| 28 October 2009 | LTIP | 9,088 | 1 | 493 | 44,713 |
| 24 August 2010 | LTIP | 33,000 | 1 | 493 | 162,360 |

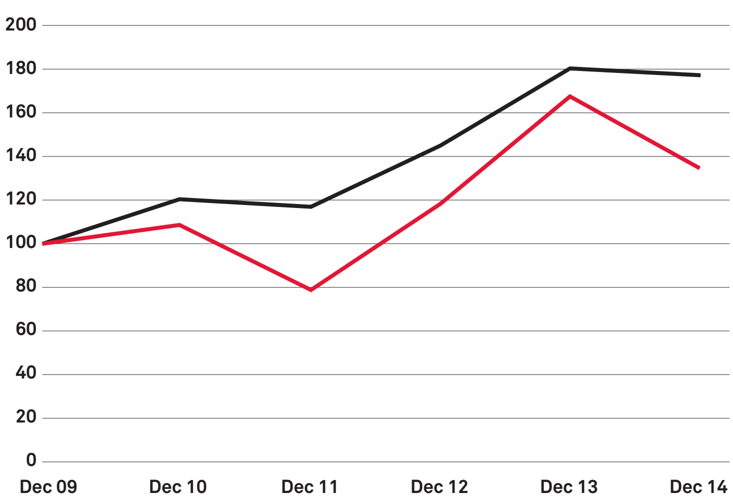
* Gain on exercise is stated before income taxes. The gain also excludes the liability of the Director to reimburse the Company in respect of Employers' National Insurance triggered at the point of exercise.

### Shareholder dilution

In accordance with the Association of British Insurers' guidelines, the Company can issue a maximum of 10% of its issued share capital in a rolling ten-year period to employees under all its share plans. In addition, of this 10% the Company can issue 5% to satisfy awards under discretionary or Executive plans. The Company operates all its share plans within these guidelines.

### Performance graph and table

The graph below shows the Group's performance, measured by TSR compared with the constituents of the FTSE All Share Support Service Sector over the last five years. The Index is the most relevant to compare the Group's performance against its peers.




The table below shows the Chief Executive Officer's remuneration package over the past five years, together with incentive payout/vesting as compared to the maximum opportunity.

| Year | Name | Single figure of total remuneration (£'000) | Bonus pay out (as % maximum) opportunity | Long-term incentive vesting rates (as % maximum opportunity) |
|---|---|---|---|---|
| 2014 | D J Miles | 412 | — | 35% |
| 2013 | D J Miles | 825 | — | 100% |
| 2012 | D J Miles | 409 | 0% | — |
| 2011 | D J Miles | 384 | 0% | — |
| 2010 | D J Miles | 270 | 0% | — |
| | R Holt | 600 | 0% | — |

### Percentage change in Chief Executive Officer's remuneration

The table below compares the percentage change in the salary of the Chief Executive Officer's with the wider employee population.

| | Salary | Salary Benefits | Bonus |
|---|---|---|---|
| Chief Executive Officer | 0% | 0% | — |
| Office salaries | +2% | 0% | 0% |

Under the MIP, an annual contribution for the year ended 31 December 2014 was delivered at 89% of salary. This will be delivered entirely in shares which will be released over a period of three years; no cash bonus is paid in respect of the 2014 financial year. If 50% of the MIP plan balance had been taken in cash, then the bonus would have reflected a 24% reduction on the previous year.

# **Remuneration report** continued

## **Annual report on remuneration** continued

### Relative importance of spend on pay

The table below sets out the relative importance of spend on pay in the financial year and previous financial year compared with other disbursements from profit.

| Significant distributions | Disbursements from profit in financial year £'000 | Disbursements from profit in previous financial year £'000 | % change |
|---|---|---|---|
| Total Directors' pay | 1,460 | 2,375 | -39% |
| Profit distributed by way of dividend | 9,252 | 8,116 | +14% |
| Underlying profit before tax | 42,000 | 36,630 | +15% |

## Statement of implementation of remuneration policy in the following financial year

### Executive Directors

Salary

The salaries for the forthcoming year are set out below:

| Executive Director | **2015** | 2014 | % change |
|---|---|---|---|
| R Holt | **£250,000** | £250,000 | — |
| D J Miles | **£363,000** | £330,000 | +10% |
| A C M Smith | **£242,000** | £220,000 | +10% |
| A Long | **£198,000** | £180,000 | +10% |

MIP

Details of the maximum and target MIP opportunities potentials along with the performance measures and their respective weightings for the year ended 31 December 2014 for Executive Directors (excluding R Holt) are set out below:

| MIP opportunity | | Performance measure weighting (% award) | |
|---|---|---|---|
| Target (% of salary) | Maximum (% of salary) | Earnings per share | Total shareholder return |
| 50% | 250% | 80% | 20% |

The 2015 MIP performance conditions are as follows:

| Condition | Weighting | Payout range (threshold to maximum contribution |
|---|---|---|
| Earnings per share (EPS) | 80% | 8%–13% from baseline diluted normalised EPS of 33.0p (pre share-based payments and the costs relating to the MIP) |
| Total shareholder return (TSR) | 20% | 10%–15% from baseline share price of £3.73 |
| EBITA cash conversion (underpin) | N/A | Cash conversion target of 80%. If this measure underpin is not met (but the other is) then the annual contribution, if any, will be reduced by 50% |
| ROCE (underpin) | N/A | ROCE target of 10%. If the underpin is not met (but the other is) then the annual contribution, if any, will be reduced by 50% |

EPS and TSR are considered key indicators of the Company's performance and success – the former as it is directly aligned to the Company's strategic objectives over the longer term and the latter as it provides a direct measure of the value created for shareholders. Financial underpins will also be implemented in order to ensure that overall corporate performance is satisfactory and the Company's financial health is stable before contributions are made. A minimum level of performance will also be considered to ascertain whether any deductions in relation to the accumulated plan accounts is necessary.

In setting these targets, the Committee is taking under consideration (amongst other items):

- the Company's 2015 business plan;
- consensus forecasts for the Company; and
- alignment with the Company's business strategy.

Pension

Details of pension contributions for the year ended 31 December 2014 are set out below:

| Executive Director | Pension |
|---|---|
| R Holt | 30% |
| D J Miles | 15% |
| A C M Smith | 15% |
| A Long | 15% |

## Statement of implementation of remuneration policy in the following financial year continued

### Non-Executive Directors

The following table sets out the fee rates for the Non-Executive Directors:

| | 2015 | 2014 | % change |
|---|---|---|---|
| D L Hosein | **£45,000** | £45,000 | — |
| M G Rogers | **£45,000** | £45,000 | — |
| P F Dicks | **£45,000** | £45,000 | — |
| D Marston | **£45,000** | £45,000 | — |
| R Macnamara | **£45,000** | £45,000 | — |

### Role of the Committee and activities

The Committee determines the total individual remuneration packages of each Executive Director of the Group and certain other senior employees (and any exit terms) and recommends to the Board the framework and broad policies of the Group in relation to Senior Executive remuneration. The Committee determines the targets for all of the Group's performance related remuneration and exercises the Board's powers in relation to all of the Group's share and incentive plans.

There is a formal and transparent procedure for developing policy on Executive remuneration and for determining the remuneration of individual Directors.

The Remuneration Committee is responsible for:

- determining and agreeing with the Board the broad remuneration policy for:
  - the Chairman, the Executive Directors and senior management; and
  - the Executive Directors' remuneration and other benefits and terms of employment, including performance related bonuses and share options; and
- approving the service agreements of each Executive Director, including termination arrangements.

No Director is involved in determining his/her own remuneration.

### Annual overview

The Committee has continued to work to build investor confidence with regard to its Executive remuneration policies and remains committed to the following actions:

- improve the level of openness and transparency in remuneration reporting through a detailed annual Remuneration Report;
- operate a structured bonus arrangement with clear financial performance targets for each year;
- undertake a regular review of the remuneration policies for Executive Directors and other Senior Executives within the Group to ensure that they remain appropriate to retain and motivate such individuals;
- take into account the changes to principles proposed by the Walker Review and other pronouncements by regulatory bodies and institutional shareholders and their representative bodies;
- consider pay policies within the Group as a whole when determining Executive Directors' remuneration packages;
- encourage Executive Directors and Senior Executives to build up a meaningful shareholding in the Company to more closely align the interests of shareholders and Executives; and
- to be kept fully aware and informed on developments and best practice in the field of remuneration and corporate governance from external advisers, institutional shareholders and their representative bodies.

Notwithstanding the above, the Committee recognises that the success of the Group is dependent upon the efforts of key individuals and that they should be fairly rewarded for their efforts and contributions in making Mears the success it is. The following section details how remuneration is structured and the factors taken into account when devising the remuneration policy.

### Advisers to the Committee

In 2014, the Committee continued to engage PwC and received wholly independent advice on Executive compensation. PwC is a member of the Remuneration Consultants' Group and complies with its code of conduct which sets out guidelines to ensure that its advice is independent and free of undue influence. Fees paid to PwC in respect of these services in the year ended 31 December 2014 were £19,000.

### Statement of voting at general meeting

The table below shows the advisory vote on the Directors' Remuneration Report together with the resolutions in respect of the Remuneration Future Policy:

| Item | Votes for | % | Votes against | % | Votes withheld |
|---|---|---|---|---|---|
| To approve the Directors' Remuneration Report | 46,877,022 | 59 | 33,209,794 | 41 | 750 |
| To approve the Remuneration Future Policy | 73,170,260 | 91 | 7,350,317 | 9 | 3,688 |

The total number of ordinary shares eligible to vote at the AGM was 101,060,781.

# Report of the Directors

The Directors present their report together with the consolidated financial statements for the year ended 31 December 2014.

## Principal activities

The principal activities of the Group are the provision of a range of outsourced services to the public and private sectors. The principal activity of the Company is to act as a holding company.

## Business review

The Company is required to set out a fair review of the business of the Group during the reporting period. The information that fulfils this requirement can be found in the Strategic Report, Review of Operations and Financial Review. The results of the Group can be found within the Consolidated Income Statement. Information required to be disclosed in respect of emissions and future developments is included within the Strategic Report.

## Dividend

The final dividend in respect of 2013 of 6.30p per share was paid in July 2014. An interim dividend in respect of 2014 of 2.85p was paid to shareholders in November 2014. The Directors recommend a final dividend of 7.15p per share for payment on 2 July 2015 to shareholders on the Register of Members on 12 June 2015. This has not been included within the consolidated financial statements as no obligation existed at 31 December 2014.

## Corporate governance

Details of the Group's corporate governance are set out on pages 38 to 44.

## Key performance indicators (KPIs)

We focus on a range of key indicators to assess our performance. Our performance indicators are both financial and non-financial and ensure that the Group targets its resources around its customers, employees, operations and finance. Collectively they form an integral part of the way that we manage the business to deliver our strategic goals. Our primary performance indicators are detailed on pages 14 and 15.

## Directors

The present membership of the Board is set out with the biographical detail on page 39.

In line with current practice, all of the Directors will retire and, being eligible, offer themselves for re-election at the AGM in June 2015.

The beneficial interests of the Directors in the shares of the Company at 31 December 2014 and 31 December 2013 are detailed within the Remuneration Report on page 60.

The process governing the appointment and replacement of Directors is detailed within the Report of the Nomination Committee on page 45.

## Amendment to Articles of Association

The Company's Articles of Association can be amended only by a special resolution of the members, requiring a majority of not less than 75% of such members voting in person or by proxy.

## Appointment of Directors

Directors are appointed by ordinary resolution, or the existing Directors may appoint a person as a Director to either fill a vacancy or as an additional Director provided that the number of Directors does not exceed the maximum permissible. Any person appointed by the Directors must retire at the next AGM but will be eligible for re-election at that meeting.

## Share capital authorisations

The 2014 AGM held in June 2014 authorised:

- the Directors to allot shares within defined limits. The Companies Act 2006 requires Directors to seek this authority and, following changes to FSA rules and institutional guidelines, the authority was limited to one third of the issued share capital, a total of £336,481 plus an additional one third of issued share capital of £336,481 that can only be used for a rights issue or similar fund raising; and
- the Directors to issue shares for cash on a non pre-emptive basis. This authority was limited to 5% of the issued share capital of £50,472 and is required to facilitate technical matters such as dealing with fractional entitlements or possibly a small placing.

Further details of these authorisations are available in the notes to the 2014 Notice of AGM. Shareholders are also referred to the 2015 Notice of AGM which contains similar provisions in respect of the Company's equity share capital as detailed below.

## AGM

The 2015 AGM will be held at the offices of Buchanan, 107 Cheapside, London EC2V 6DN on 3 June 2015 at 9.30am and a formal Notice of Meeting and Form of Proxy are enclosed. The ordinary business to be conducted will include the re-appointment of all Directors.

The special business will comprise the following resolutions:

- to authorise the Directors to allot shares within defined limits. The Companies Act 2006 requires Directors to seek this authority and, following changes to FSA rules and institutional guidelines, the authority, as in previous years, will be limited to one third of the issued share capital, a total of £338,997 plus an additional one third of issued share capital of £338,997 that can only be used for a rights issue or similar fund raising;
- to authorise the Directors to issue shares for cash on a non pre-emptive basis. This authority is limited to 5% of the issued share capital of £50,847 and is required to facilitate technical matters such as dealing with fractional entitlements or possibly a small placing;
- to authorise the convening of general meetings (other than an AGM) on 14 days' notice. This results from a European Union Directive that became effective on 3 August 2010 and will override Section 307 of the Companies Act 2006 where the requirement to give 21 days' notice for certain meetings has been amended; and

## AGM continued

- to amend the Company's memorandum of association which places a restriction on the authorised share capital of the Company. The requirement for a company to have an authorised share capital was removed when the Companies Act 2006 came into force and the Directors believe that it is no longer appropriate for the Company's share capital to be limited in this way.

## Principal risks and uncertainties

Risk is an accepted part of doing business. The Group's financial risk management is based upon sound economic objectives and good corporate practice. The Board has overall responsibility for risk management and internal control within the context of achieving the Group's objectives. Our process for identifying and managing risks is set out in more detail within the Corporate Governance Statement. The key risks and mitigating factors are set out on pages 22 to 25. Details of financial risk management and exposure to price risk, credit risk and liquidity risk are given in note 20 on pages 105 to 110.

## Contracts of significance

The Group is party to significant contracts within each segment of its business. The Directors do not consider that any one of those contracts is essential in its own right to the continuation of the Group's activities.

## Payment policy

The Company acts purely as a holding company and as such is non-trading. Accordingly, no payment policy has been defined. However, the policy for Group trading companies is to set the terms of payment with suppliers when entering into a transaction and to ensure suppliers are aware of these terms. Group trade creditors during the year amounted to 57 days (2013: 58 days) of average supplies for the year.

## Capital structure

The Group is financed through both equity share capital and debt. Details of changes to the Company's share capital are given in note 22 to the financial statements. The Company has a single class of shares – ordinary 1p shares – with no right to any fixed income and with each share carrying the right to one vote at the general meetings of the Company. Under the Company's Articles of Association, holders of ordinary shares are entitled to participate in any dividends pro-rata to their holding. The Board may propose and pay interim dividends and recommend a final dividend for approval by the shareholders at the AGM. A final dividend may be declared by the shareholders in a general meeting by ordinary resolution but such dividend cannot exceed the amount recommended by the Board.

## Substantial shareholdings

As at 2 March 2015 the Company has been notified of, or is aware of, the shareholders holding 3% or more of the issued share capital of the Company, as detailed in the table adjacent.

| Fund manager | City | Number (m) | % |
|---|---|---|---|
| Majedie Asset Management | London | 9.6 | 9.4 |
| Heronbridge Investment Management | Bath | 8.2 | 8.1 |
| Fidelity Worldwide Investment | London | 5.7 | 5.6 |
| Legal & General Investment Management | London | 5.6 | 5.5 |
| Invesco Perpetual | London | 4.2 | 4.1 |
| Artemis Investment Management | Edinburgh | 3.9 | 3.8 |
| Denver Investment Advisors | Denver | 3.3 | 3.2 |
| Neptune Investment Management | London | 3.3 | 3.2 |
| Wellington Management | Boston | 3.2 | 3.2 |
| Teachers RS of Georgia | Atlanta | 3.1 | 3.1 |
| Old Mutual Global Investors | London | 3.1 | 3.1 |
| Threadneedle Investments | London | 3.1 | 3.1 |
| | | 56.2 | 55.3 |

## Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

## Employee information and consultation

The Group has received recognition under the 'Investors in People' award. The Group continues to involve its staff in the future development of the business. Information is provided to employees through a daily news email, a quarterly newsletter posted out to all staff, the Group website and the intranet to ensure that employees are kept well informed of the performance and objectives of the Group.

## CREST

CREST is the computerised system for the settlement of share dealings on the London Stock Exchange. CREST reduces the amount of documentation required and also makes the trading of shares faster and more secure. CREST enables shares to be held in an electronic form instead of the traditional share certificates. CREST is voluntary and shareholders can keep their share certificates if they wish. This may be preferable for shareholders who do not trade in shares on a frequent basis.

## Auditor

Grant Thornton UK LLP offers itself for re-appointment as auditor in accordance with Section 489 of the Companies Act 2006.

On behalf of the Board

**B Westran**
**Company Secretary**
ben.westran@mearsgroup.co.uk
17 March 2015

# Statement of Directors' responsibilities

In respect of the Directors' Report and financial statements

## The Directors are responsible for preparing the Annual Report, the Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and have elected to prepare the Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and Applicable Laws). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs and profit or loss of the Group and the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements and Remuneration Report comply with the Companies Act 2006 and Article 4 of the IAS regulation. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors confirm that:

- so far as each Director is aware there is no relevant audit information of which the Company's auditor is unaware; and
- the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

To the best of my knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Annual Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

The Directors are responsible for preparing the Annual Report in accordance with applicable law and regulations. The Board considers the Report and Accounts, taken as a whole, as fair, balanced and understandable and that it provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

## Going concern

We principally operate in robust defensive markets, Social Housing and Care, where spend is largely non-discretionary and our contracts tend to be long-term partnerships.

The Group had net cash of £3.8m at 31 December 2014. The core debt required to satisfy the day-to-day requirements of the business is in the region of £79m. This represents significant headroom against the £120m unsecured revolving credit facility, with an additional accordion mechanism allowing the facility to be increased to a maximum of £160m, maturing in July 2018.

After reviewing the Group's and Company's budget for the next financial year and longer-term plans, the Directors consider that, as at the date of approving the financial statements, it is appropriate to adopt the going concern basis in preparing the financial statements.

By order of the Board

**A C M Smith**
**Finance Director**
andrew.smith@mearsgroup.co.uk
17 March 2015

# Independent auditor's report

To the members of Mears Group PLC



## Our opinion on the financial statements is unmodified

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2014 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS regulation.

## What we have audited

Mears Group PLC's financial statements comprise the Group principal accounting policies, the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated balance sheet, the Consolidated cash flow statement, the Consolidated statement of changes in equity and the related Group notes, the Company principal accounting policies, the Parent company balance sheet and the related Company notes.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is United Kingdom Generally Accepted Accounting Practice.

## Our assessment of risk

Without modifying our opinion, we highlight the following matters that are, in our judgement, likely to be most important to users' understanding of our audit.

| Audit risk | How we responded to the risk |
|---|---|
| **Revenue recognition of Social Housing contracts** | **Our audit work included, but was not restricted to:** |
| The Group's accounting policy on revenue recognition and disclosure of related critical judgements are included in the Group principal accounting policies on pages 74 to 76 and 79 respectively. The Audit Committee Chair has also commented on this area in her report on page 48.<br><br>The revenue from the Group's Social Housing contracts represents 85.2% of the Group's total revenue of £838.7m.<br><br>Revenue is recognised throughout the Group at the fair value of consideration receivable in respect of provision of services. Provision is made for expected contract losses as soon as they are foreseen.<br><br>Determining the amount of revenue and profit to be recognised in the consolidated financial statements depends on the terms and conditions of the individual contract and can involve key judgements such as the recoverability of work in progress and the credibility of assumptions underpinning the estimated future performance of contracts that are currently loss making.<br><br>We therefore identified revenue recognition relating to these contracts as a significant risk. | • an evaluation of the methodology by which the Directors determine the amount of revenue and profit to recognise based on each type of contract as disclosed in the accounting policies. This included assessing whether the accounting policies adopted by the Directors are in accordance with the requirements of International Accounting Standard (IAS) 11 and IAS 18;<br><br>• testing key controls, where applicable, over the recognition of revenue and the allocation of costs to the contracts, including invoicing, cost approval and cost allocation;<br><br>• selecting a sample of contracts in progress at the year-end by reference to materiality and other risk factors including those requiring significant estimates by management, those contracts that are currently loss making and contracts with significant aged work in progress and debtor balances;<br><br>• for the sample selected we have assessed whether the revenue and profit recognised were in accordance with the Group's accounting policies by agreeing inputs to contract terms, re-performing management's calculations and assessing management's assumptions and assertions underpinning their forecasts for contract's future performance by reference to supporting documentation and discussions with key operations personnel;<br><br>• reviewing contracts that were loss making in the year and challenging management's assumptions and assertions relating to the future profitability of those contracts by reference to supporting evidence such as management's plans to address the position, forecast models, previous history of turning around loss making contracts, the opinions of key operational personnel and correspondence with clients where appropriate. We also physically visited a number of loss making sites during the year in order to further understand the operations; and<br><br>• investigating the recoverability of receivables and work in progress balances by reference to post balance sheet cash collection, certifications and correspondence from customers, and examining the Group's historical experience of recovery. |

# **Independent auditor's report** continued

To the members of Mears Group PLC

## **Our assessment of risk** continued

| Audit Risk | How we responded to the risk |
|---|---|
| **Assessment of goodwill impairment in relation to the Care division** | **Our audit work included, but was not restricted to:** |
| The Group's accounting policy on impairment reviews and disclosure of related critical judgements are included in the notes and in the Group principal accounting policies on pages 73 and 80 respectively. The Audit Committee Chair has also commented on this area in her report on page 47. As more fully explained in those policies the Directors are required to make an annual assessment to determine whether the value of goodwill of £192.0m, of which £98.0m relates to the Care division, is impaired.<br><br>The process for measuring and recognising impairment under IAS 36 'Impairment of Assets' is complex and judgemental, particularly in relation to the Care division which is continuing to develop its business offering.<br><br>We therefore identified the impairment review in relation to the Care division as a significant risk. | • obtaining management's discounted cash flow forecast for the Care division used in the impairment review and comparing it to our understanding of the division and recalculating the arithmetical accuracy of those calculations;<br>• challenging the assumptions utilised in the impairment models, including the growth rates, discount rates and forecast profitability. We involved our specialist valuation team to consider whether the assumptions and the model used were appropriate to the division and, where possible, benchmarked these assumptions against wider industry data;<br>• challenging management's sensitivity analysis performed in respect of the key assumptions such as the growth rates and discount rates to ensure the assumptions were not overly aggressive; and<br>• testing the accuracy of management's forecasting through a comparison of budget to actual data and historical variance trends and reviewing the cash flows for exceptional or unusual items or assumptions. |
| **Valuation of defined benefit retirement scheme obligations** | **Our audit work included, but was not restricted to:** |
| The Group's accounting policy on defined benefit pension scheme accounting is included in the Group principal accounting policies on pages 76 and 77. The Audit Committee Chair has also commented on this area in her report on page 46.<br><br>The Group has a number of defined benefit pension plans. At 31 December 2014 the defined benefit pension schemes had combined a combined net surplus of £24.5m, of which £6.8m is recognised in the financial statements. The gross value of the pension assets and obligations which form the net surplus amounted to £462.9m and £438.4m respectively.<br><br>The measurement of the obligation in accordance with IAS 19 (Revised) 'Employee benefits' involves significant judgement and their valuation is subject to complex actuarial assumptions. Small variations in those actuarial assumptions can lead to a materially different value of pension liabilities being recognised within the Group financial statements.<br><br>We therefore identified the valuation of the defined benefit obligations as a significant risk. | • testing the appropriateness of the valuation methodologies and their inherent actuarial assumptions by benchmarking key assumptions such as discount rates, wages and salary growth rates and mortality rates to available market data. We also utilised the expertise of our actuarial specialists in order to review the appropriateness of the assumptions used in the calculation methods employed in the calculation of the obligation;<br>• testing the accuracy of underlying membership data utilised by the Group's actuaries for the purpose of calculating the scheme liabilities by selecting a sample of employees and agreeing key standing data such as date of birth, gender and date of membership to underlying records; and<br>• considering the appropriateness of the recognition of any scheme surpluses by reference to the scheme rules. |

## Our application of materiality and an overview of the scope of our audit

### Materiality

We apply the concept of materiality in planning and performing our audit, in evaluating the effect of any identified misstatements and in forming our opinion. For the purpose of determining whether the financial statements are free from material misstatement we define materiality as the magnitude of a misstatement or an omission from the financial statements or related disclosures that would make it probable that the judgement of a reasonable person relying on the information would have been changed or influenced by the misstatement or omission. We also determine a level of performance materiality, which we use to determine the extent of testing needed to reduce to an appropriately low level the probability that the aggregate of uncorrected misstatements exceeds materiality for the financial statements as a whole.

We determined materiality for the Group as a whole to be £2,100,000, which is approximately 5% of profit for the year before tax, exceptional costs and the amortisation of acquisition intangibles, as this is a key performance measure used by the Board of Directors to report to investors on the financial performance of the Group. We set an underlying performance materiality threshold of 75% of Group materiality to direct and focus our audit testing. We chose this threshold based on our assessment of the control environment obtained during our risk assessment procedures. The audits undertaken for Group reporting purposes of the components noted below were carried out to a materiality level that did not exceed our level of performance materiality. We also determine a lower level of specific materiality for certain areas such as directors' remuneration and related party transactions.

We agreed with the Audit Committee that we would report to them misstatements above £105,000 identified during our audit, which represents 5% of Group materiality. We would also report misstatements identified below that amount if there were qualitative factors that would warrant the attention of the committee.

## Overview of the scope of our audit

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland). Our responsibilities under those standards are further described in the 'Responsibilities for the financial statements and the audit' section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Group in accordance with the Auditing Practices Board's Ethical Standards for Auditors, and we have fulfilled our other ethical responsibilities in accordance with those Ethical Standards.

Our audit approach was based on a thorough understanding of the Group's business and is risk based. In order to address the risks described above as identified during our planning procedures, we performed a full scope audit of the consolidated financial statements of the Parent Company, Mears Group PLC, and of the Group's operations throughout the United Kingdom.

The components of the Group were evaluated by the group audit team based on a measure of materiality considered as a percentage of total Group assets, revenues and profit before taxes, to assess the significance of the component and to determine the planned audit response. For those components that we determined were significant, either a full scope or targeted approach was determined based on their relative materiality to the Group and our assessment of audit risk.

For significant components requiring a full scope approach an interim visit was conducted before the year end to undertake substantive procedures in advance of the final visit and to evaluate the Group's internal control environment including its IT systems. We then evaluated and tested controls over the financial reporting systems identified as part of our risk assessment, reviewed the accounts production process and addressed critical accounting matters. We sought, wherever possible, to rely on the effectiveness of the Group's internal controls in order to reduce substantive testing. We then undertook substantive testing on significant transactions and material account balances, including the procedures outlined above in relation to the key risks. For the components where we took a targeted approach a similar testing strategy was applied, focused on the significant transactions and material account balances.

The operations that were subject to either full scope audit procedures or a targeted approach make up over 90% of total revenues.

The remaining non-significant components of the Group were subject to analytical procedures over their information packs after taking into account the risks identified above and the significance of the component to the Group.

# Independent auditor's report continued

To the members of Mears Group PLC

## Other reporting required by regulations

**Our opinion on other matters prescribed by the Companies Act 2006 is unmodified**

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to report to you if:

- we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable; or
- the Annual Report does not appropriately disclose those matters that were communicated to the Audit Committee which we consider should have been disclosed.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules, we are required to review:

- the Directors' statement, set out on page 66, in relation to going concern; and
- the part of the Corporate Governance Report relating to the Company's compliance with the ten provisions of the UK Corporate Governance Code specified for our review.

## Responsibilities for the financial statements and the audit

### What an audit of financial statements involves

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

### What the Directors are responsible for

As explained more fully in the Statement of Directors' Responsibilities set out on page 66, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

### What we are responsible for

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Who we are reporting to

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Simon Lowe**
**Senior Statutory Auditor**
**for and on behalf of Grant Thornton UK LLP**
**Statutory Auditor, Chartered Accountants**
**Bristol**
17 March 2015

# Principal accounting policies – Group



## Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with IFRS as adopted by the European Union. The financial statements are prepared under the historical cost convention.

The accounting policies remain unchanged from the previous year except for the adoption of IAS 27 (Revised) 'Separate Financial Statements'; IAS 28 (Revised) 'Investments in Associates and Joint Ventures'; Amendments to IFRS 7 'Financial Instruments: Disclosures'; IFRS 10 'Consolidated Financial Statements'; IFRS 11 'Joint Arrangements'; IFRS 12 'Disclosures of Interests in Other Entities'; and Amendments to IAS 39 'Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting'.

The adoption of these amendments and new standards has had no material effect of the Group's financial statements.

The Directors consider that as at the date of approving the financial statements, there is a reasonable expectation that the Group and Company have adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the financial statements. The Directors have discussed the principal risks and uncertainties of the business in the Risk Management section on pages 22 to 25.

## Basis of consolidation

The Consolidated Balance Sheet includes the assets and liabilities of the Company and its subsidiaries and is made up to 31 December 2014. Entities over which the Group has the ability to exercise control over financial and operating policies are accounted for as subsidiaries. Control is obtained and exercised through voting rights so as to obtain benefits from the subsidiaries' activities. Interests acquired in entities are consolidated from the effective date of acquisition and interests sold are consolidated up to the date of disposal.

A joint venture is a joint arrangement whereby the parties that have joint control have the rights to the net assets of the arrangement. Investments in joint ventures are accounted for using the equity method of accounting. Under this method, the Group's share of post-acquisition profits or losses is recognised in the Consolidated Income Statement; the cost of the investment in a given joint venture, together with the Group's share of that entity's post-acquisition changes to shareholders' funds, is included in Investments within the Consolidated Balance Sheet.

All significant intercompany transactions and balances between Group enterprises, including unrealised profits arising from intra-group transactions, are eliminated on consolidation; no profit is taken on sales between Group companies.

## Business combinations

Business combinations are accounted for using the acquisition method. The acquisition method involves the recognition at fair value of all identifiable assets and liabilities, including contingent liabilities of the subsidiary at the acquisition date, regardless of whether or not they were recorded in the financial statements of the subsidiary prior to acquisition. On initial recognition, the assets and liabilities of the subsidiary are included in the Consolidated Balance Sheet at their fair values, which are also used as the bases for subsequent measurement in accordance with the Group accounting policies. Goodwill is stated after separating out identifiable intangible assets. Goodwill represents the excess of acquisition cost over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition.

Where applicable the consideration for an acquisition includes any assets or liabilities arising from a contingent consideration arrangement, measured at fair value at the acquisition date. Subsequent changes in such fair values are adjusted against the cost of acquisition where they result from additional information obtained up to one year from the acquisition date about facts and circumstances that existed at the acquisition date. All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are recognised in accordance with IAS 39, either in the Consolidated Income Statement or Consolidated Statement of Comprehensive Income.

Costs relating to acquisitions in the year have been expensed.

Any business combinations prior to 1 January 2010 were accounted for in accordance with the standards in place at the time, which differ in the following respects: transaction costs directly attributable to the acquisition formed part of the acquisition costs; contingent consideration was recognised if, and only if, the Group had a present obligation, the economic outflow was more likely than not and a reliable estimate was determinable; and subsequent adjustments to the contingent consideration were recognised as part of goodwill.

# Principal accounting policies – Group continued

## Property, plant and equipment

Items of property, plant and equipment are stated at historical cost, net of depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow into the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the Income Statement during the financial period in which they are incurred.

Freehold land is not depreciated. Depreciation on other assets is calculated to write down the cost less estimated residual value over their estimated useful economic lives. The rates generally applicable are:

| | | |
|---|---|---|
| Freehold buildings | – | 2% p.a., straight-line |
| Leasehold improvements | – | over the period of the lease, straight-line |
| Plant and machinery | – | 25% p.a., reducing balance |
| Fixtures, fittings and equipment | – | 25% p.a., reducing balance |
| Motor vehicles | – | 25% p.a., reducing balance |

Residual values are reviewed annually and updated if appropriate. The carrying value is reviewed for impairment in the period if events or changes in circumstances indicate the carrying value may not be recoverable. An asset's carrying value is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within administrative expenses in the Income Statement.

## Intangible assets

In accordance with IFRS 3 (Revised) 'Business Combinations', an intangible asset acquired in a business combination is deemed to have a cost to the Group of its fair value at the acquisition date. The fair value of the intangible asset reflects market expectations about the probability that the future economic benefits embodied in the asset will flow to the Group. Where an intangible asset might be separable, but only together with a related tangible or intangible asset, the group of assets is recognised as a single asset separately from goodwill where the individual fair values of the assets in the Group are not reliably measurable. Where the individual fair value of the complementary assets are reliably measurable, the Group recognises them as a single asset provided the individual assets have similar useful lives. Intangible assets are amortised over the useful economic life of those assets.

Development costs incurred on software development are capitalised when all the following conditions are satisfied:

- completion of the software module is technically feasible so that it will be available for use;
- the Group intends to complete the development of the module and use it;
- the software will be used in generating probable future economic benefits;
- there are adequate technical, financial and other resources to complete the development and to use the software; and
- the expenditure attributable to the software during its development can be measured reliably.

Costs incurred making intellectual property available for use (including any associated borrowing costs) are capitalised when all of the following conditions are satisfied:

- completion of the data set is technically feasible so that it will be available for use;
- the Group intends to complete the preparation of the data and use it;
- the data will be used in generating probable future economic benefits;
- there are adequate technical, financial and other resources to complete the data set and to use it; and
- the expenditure attributable to the intellectual property during its development can be measured reliably.

Development costs not meeting the criteria for capitalisation are expensed as incurred. Careful judgement by management is applied when deciding whether the recognition requirements for development costs have been met. This is necessary as the economic success of any development is uncertain and may be subject to future technical problems at the time of recognition. Judgements are based on the information available at each balance sheet date. In addition, all internal activities related to the research and development of new software are continually monitored by management.

## Intangible assets continued

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in the manner intended by management. Directly attributable costs include employee costs incurred on software development.

Amortisation commences upon completion of the asset and is shown within other administrative expenses. Until the asset is available for use on completion of the project, the assets are subject to impairment testing only. Development expenditure is amortised over the period expected to benefit.

The identifiable intangible assets and associated periods of amortisation are as follows:

| | | |
|---|---|---|
| Order book | – | over the period of the order book, typically three years |
| Client relationships | – | over the period expected to benefit, typically five years |
| Development expenditure | – | 25% p.a., straight-line |
| Intellectual property | – | over the period of usefulness of the intellectual property, typically five years |

## Goodwill

Goodwill arises on the acquisition of subsidiaries and represents any excess of the cost of the acquired entity over the Group's interest in the fair value of the entity's identifiable assets and liabilities acquired and is capitalised as a separate item. Goodwill is recognised as an intangible asset.

Under the business combinations exemption of IFRS 1, goodwill previously written off directly to reserves under UK GAAP is not recycled to the Income Statement on calculating a gain or loss on disposal.

## Impairment

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows: cash-generating units (CGUs). As a result, some assets are tested individually for impairment and some are tested at CGU level. Goodwill is allocated to those CGUs that are expected to benefit from synergies of the related business combination and represent the lowest level within the Group at which management monitors the related cash flows.

Goodwill, other individual assets or CGUs that include goodwill and those intangible assets not yet available for use are tested for impairment at least annually. All other individual assets or CGUs are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised in the Income Statement for the amount by which the asset or CGU's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell, and value in use based on an internal discounted cash flow evaluation. Impairment losses recognised for CGUs, to which goodwill has been allocated, are credited initially to the carrying amount of goodwill. Any remaining impairment loss is charged pro-rata to the other assets in the CGU. With the exception of goodwill, all assets are subsequently reassessed for indications that an impairment loss previously recognised may no longer exist.

## Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is the actual purchase price of materials.

## Work in progress

Work in progress is included in inventories after deducting any foreseeable losses and payments on account not matched with revenue. Work in progress represents costs incurred on contracts that cannot be matched with contract work accounted for as revenue. Work in progress is stated at the lower of cost and net realisable value. Cost comprises materials, direct labour and any subcontracted work that has been incurred in bringing the inventories and work in progress to their present location and condition.

## Amounts recoverable on contracts

Amounts recoverable on contracts are included in trade and other receivables and represent revenue recognised in excess of payments on account.

# Principal accounting policies – Group continued

## Accounting for taxes

Income tax comprises current and deferred taxation.

Current tax assets and/or liabilities comprise those obligations to, or claims from, fiscal authorities relating to the current or prior reporting period that are unpaid at the balance sheet date. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year.

Where an item of income or expense is recognised in the Income Statement, any related tax generated is recognised as a component of tax expense in the Income Statement. Where an item is recognised directly to equity or presented within the Consolidated Statement of Comprehensive Income, any related tax generated is treated similarly.

Deferred taxation is the tax expected to be repayable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method.

Deferred taxation liabilities are generally recognised on all taxable temporary differences in full with no discounting. Deferred taxation assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. However, deferred tax is not provided on the initial recognition of goodwill, nor on the initial recognition of an asset or liability, unless the related transaction is a business combination or affects tax or accounting profit.

Deferred taxation is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, provided they are enacted or substantively enacted at the balance sheet date. The carrying value of deferred taxation assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available against which taxable temporary differences can be utilised. Deferred tax is charged or credited to either the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income or equity to the extent that it relates to items charged or credited.

## Revenue

Revenue is measured in accordance with IAS 18 ‘Revenue’ and IAS 11 ‘Construction Contracts’ at the fair value of the consideration received or receivable, for goods and services provided in the normal course of business, net of rebates and discounts and after eliminating sales within the Group.

### Social Housing

Revenue is recognised when the outcome of a job or contract can be estimated reliably; revenue associated with the transaction is recognised by reference to the stage of completion of work at the balance sheet date. The outcome of the transaction is deemed to be able to be estimated reliably when all the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity;
- the stage of completion of the transaction at the balance sheet date can be measured reliably; and
- the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Whilst all Social Housing contracts can fit within the guidelines laid down for revenue recognition as detailed above, the alternative contractual pricing mechanisms do result in different methods of assessing the stage of completion. The Group has therefore recognised revenue dependent on the nature of transactions in line with IAS 18.

There are some contracts where we are entitled to a fee to reimburse the costs relating to a new contract start-up. This fee is sometimes paid on commencement or paid in instalments over an extended period. Where the contractual entitlement to this income crystallises upon commencement, the revenue is recognised. All costs relating to pre-commencement and mobilisation are written off as they are incurred.

#### Schedule of Rates (SOR) contracts

There are numerous contractual pricing mechanisms but one can broadly divide these into three types.

There is an element of SOR in the majority of contracts. At tender stage we enter a price for each of the numerous tasks carried out in respect of property maintenance. Typically we price for uplift or a discount against a pre-priced schedule. This price will, in some cases, be an all-encompassing price for the cost of direct works, the local site overhead, central overhead and profit contribution. In other instances, the SOR tendered may only recover direct works with an alternative mechanism to recover the other elements. Wherever possible, we seek to identify all works tickets received individually and capture costs and billing at the individual work ticket level. In so doing, this allows revenue to be recognised with a high degree of accuracy. Typically, reactive maintenance works are invoiced within a month of completion, hence the majority of revenue recognised has already been valued at the individual work ticket level and the significant majority has been subsequently settled. The only element of revenue or profit recognition that requires judgement is against those jobs that are part complete or those completed works that have not been subject to a final valuation.

## **Revenue** continued

### **Social Housing** continued

#### Schedule of Rates (SOR) contracts continued

For part completed works, consideration needs to be given as to whether the Group will recover the transaction costs incurred. Whether the outcome of the transaction can be estimated reliably needs to be considered contract by contract based on historic outcomes and knowledge of any events that may affect future job profitability. Where the outcome of the transaction cannot be estimated reliably, revenue is recognised only to the extent that the costs incurred are anticipated to be recovered. Where the outcome of the transaction can be estimated reliably, an element of anticipated profit is recognised within revenue to the extent that historic outcomes adjusted for knowledge of any events that may affect future job profitability support such recognition.

For completed but not yet valued works, the outcome of the individual valued work tickets is not reviewed individually for the purposes of profit and revenue recognition. However, given the high volume of historical data to provide an accurate indication of underlying contract margin at a particular site, the Group considers that the application of an anticipated profit margin on cost to all completed and unbilled works produces a reliable measure.

For completed and valued works, the likely outcome for the individual work ticket can be determined individually for the purposes of profit and revenue recognition. The Group considers that the recognition of the anticipated profit for the individual job within revenue is appropriate.

#### Open book contracts

Typically the open book element of contracts relates to the local site overhead. A priced overhead model is usually provided to a client at tender stage and the client pays the Group a fixed sum for maintaining this local site. This is typically an agreed fixed price. Revenue is recognised in line with cost incurred and similarly the attributable profit recognised against that cost.

Any over or underspends are typically at the risk of the Group. The actual overhead spend is often subject to an open book review which is then used as the basis for agreeing future pricing.

On the rare occasions that a contract does recover costs under a pure 'cost plus' arrangement, revenue is recognised in line with cost incurred and similarly the attributable profit recognised against that cost.

#### Lump sum contracts

This type of contract is becoming more commonplace. To avoid the onerous burden of administering a high volume, low value activity, the pricing mechanism is reduced to either a price per ticket or a price per property. Historically, many gas servicing and breakdown contracts have been procured on a lump sum basis. However, it is now becoming increasingly common within the reactive maintenance environment. There is typically an exclusions list for works that are not considered repairs and not deemed to fall within the lump sum price. It is normal for this excluded element of the works to be billed under an SOR arrangement.

For practical purposes, in the majority of lump sum contracts, revenue is recognised on a straight-line basis over the contract term. There is not a material impact of seasonality in a client's reactive maintenance spend (in terms of either volume or value of orders received). In terms of the lump sum element of the contract, the revenue is split evenly across the twelve monthly reporting periods. No element of revenue is either advanced or deferred.

There are a small number of lump sum contracts where recognising revenue on a straight-line basis would be inappropriate. These are contracts where the phasing of the works over the contract term varies materially over the period of the contract and there is a mismatch between the delivery of works and the timing of invoicing against those works. For these contracts, the Group has historically reverted to recognising revenue based on the proportion of costs incurred to date compared with the estimated total costs of the contract.

#### Rental income

Rental income is recognised in the Income Statement on a straight-line basis over the term of the lease.

### **Care**

Revenue is recognised when the actual care has been delivered. Revenue relating to care delivered and not invoiced is accrued and disclosed under trade and other receivables as amounts recoverable on contracts. Revenue attributable to any unused capacity under block contracts, where the Group is able to invoice for contracted services not provided, is recognised when the recovery of income is considered virtually certain. There is minimal scope for judgement based on the care process.

Mears Care utilises rostering systems to manage care. These systems allow for planning a rota for each staff member, together with the corresponding pay and bill rates for the particular service type, length of service and time of delivery. These results are very accurate in the calculation of billable time, income and corresponding employee pay for a particular contract, branch or region.

Accrued income is determined by applying an average historical billing rate to the number of unbilled hours delivered at the balance sheet date. Variances are reviewed in the following month once actual billing is known. The rostering systems allow unbilled hours to be calculated based on planned, rostered and actual visits along with the corresponding pay and bill rates for the particular service type, length of service and time of delivery. These results are very accurate in the calculation of billable time, income and corresponding employee pay for a particular contract, branch or region.

# Principal accounting policies – Group continued

## Revenue continued

### Construction contracts

Revenue from the Mechanical & Electrical (M&E) sector reflects the contract activity during the year and is measured at the fair value of consideration received or receivable. When the outcome can be assessed reliably, contract revenue and associated costs are recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date. The stage of completion of the contract at the balance sheet date is usually assessed by comparing the proportion of costs incurred to estimated total contract costs. Where this is not representative, contract milestones are used as a basis of assessing the stage of completion. Where the outcome of a construction contract cannot be estimated reliably, revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable and contract costs are recognised as an expense in the period in which they are incurred.

In the case of a fixed price contract, the outcome of a construction contract is deemed to be estimated reliably when all the following conditions are satisfied:

- it is probable that economic benefits associated with the contract will flow to the Group;
- both the contract costs to complete the contract and the stage of completion at the balance sheet date can be measured reliably; and
- the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

The gross amount due from customers for contract work is presented as an asset for all contracts in progress for which costs incurred, plus recognised profits (less recognised losses), exceed progress billings. The gross amount due to customers for contract work is presented as a liability for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less losses).

Full provision is made for losses on all contracts in the year in which the loss is first foreseen.

## Segment reporting

Segment information is presented in respect of the Group's operating segments based upon the format that the Group reports to its chief operating decision makers.

The Group considers that the chief operating decision makers are the Executive Directors and Senior Executives of the business.

## Exceptional costs

Exceptional costs are disclosed on the face of the Consolidated Income Statement where these are material and considered necessary to explain the underlying financial performance of the Group. They are either one-off in nature or necessary elements of expenditure to derive future benefits for the Group which have not been capitalised in the Consolidated Balance Sheet.

Costs of restructure are only considered to be exceptional where the restructure is transformational and the resultant cost is significant.

Acquisition costs are only considered to be exceptional where the acquisition is significant and the resultant cost is significant.

## Employee benefits

### Retirement benefit obligations

The Group operates both defined benefit and defined contribution pension schemes as follows:

i) Defined contribution pensions

A defined contribution plan is a pension plan under which the Group pays fixed contributions into an independent entity. The Group has no legal obligations to pay further contributions after payment of the fixed contribution.

The contributions recognised in respect of defined contribution plans are expensed as they fall due. Liabilities and assets may be recognised if underpayment or prepayment has occurred and are included in current liabilities or current assets as they are normally of a short-term nature.

The assets of the schemes are held separately from those of the Group in an independently administered fund.

ii) Defined benefit pensions

The Group contributes to defined benefit schemes which require contributions to be made to separately administered funds.

## Employee benefits continued

### Retirement benefit obligations continued

ii) Defined benefit pensions continued

A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligations for any benefits from this kind of pension plan remain with the Group, even if plan assets for funding the defined benefit plan have been set aside.

Scheme liabilities are measured using the projected unit funding method, applying the principal actuarial assumptions at the Balance Sheet date. Assets are measured at market value. In accordance with IFRIC 14, the asset that is recognised is restricted to the amount by which the IAS 19 (Revised) service cost is expected, over the lifetime of the scheme, to exceed funding contributions payable in respect of accruing benefits.

Where the Group has a contractual right to recover the costs of making good any deficit in the scheme from the Group's client, the fair value of that asset has been recognised and disclosed. The right to recover costs is limited to exclude situations where the Group causes the scheme to incur service costs in excess of those which would have been incurred were the members employed within Local Government. The right to recover costs is also limited to situations where the cap on employer contributions to be suffered by the Group is not set so as to contribute to reducing the deficit in the scheme.

Actuarial gains and losses are taken to the statement of comprehensive income as incurred. For this purpose, actuarial gains and losses comprise both the effects of changes in actuarial assumptions and experience adjustments arising because of differences between the previous actuarial assumptions and what has actually occurred.

Other movements in the net surplus of deficit are recognised in the Income Statement, including the current service cost, any past service cost and the effect of curtailments or settlements. The interest costs less the expected return on assets is also charged to the Income Statement. The amount charged to the Income Statement in respect of these plans in included within operating costs.

The Group's contributions to the scheme are paid in accordance with the rules of the schemes and the recommendations of the actuary.

### Share-based employee remuneration

All share-based payment arrangements that were granted after 7 November 2002 and had not vested before 1 January 2005 are recognised in the consolidated financial statements in accordance with IFRS 2.

The Group operates equity-settled share-based remuneration plans for its employees. All employee services received in exchange for the grant of any share-based remuneration are measured at their fair values. These are indirectly determined by reference to the fair value (excluding the effect of non-market based vesting conditions) of the share options awarded. Their value is determined at the date of grant and is not subsequently remeasured unless the conditions on which the award was granted are modified. The fair value at the date of the grant is calculated using the Binomial and Monte Carlo option pricing models and the cost is recognised on a straight-line basis over the vesting period. Adjustments are made to reflect expected and actual forfeitures during the vesting period. For SAYE plans, employees are required to contribute towards the plan. This non-vesting condition is taken into account in calculating grant date fair value.

All share-based remuneration is ultimately recognised as an expense in the Income Statement with a corresponding credit to the share-based payment reserve.

Upon exercise of share options, the proceeds received net of any directly attributable transaction costs up to the nominal value of the shares issued are allocated to share capital, with any excess being recorded as share premium.

## Leases

In accordance with IAS 17 'Leases', the economic ownership of a leased asset is transferred to the lessee if they bear substantially all the risks and rewards related to the ownership of the leased asset. The related asset is recognised at the time of inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any, to be borne by the lessee. A corresponding amount is recognised as a finance leasing liability, irrespective of whether some of these lease payments are payable up front at the date of inception of the lease.

Subsequent accounting for assets held under finance lease agreements, i.e. depreciation methods and useful lives, correspond to those applied to comparable acquired assets. The corresponding finance leasing liability is reduced by lease payments less finance charges, which are expensed to finance costs. Finance charges represent a constant periodic rate of interest on the outstanding balance of the finance lease liability.

All other leases are treated as operating leases. Payment on operating lease agreements is recognised as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

The Group does not act as a lessor.

# Principal accounting policies – Group continued

## Financial instruments

Financial assets and liabilities are recognised in the Balance Sheet when the Group becomes party to the contractual provisions of the instrument. The principal financial assets and liabilities of the Group are as follows:

### Financial assets

When financial assets are recognised initially under IAS 39 'Financial Instruments: Recognition and Measurement', they are measured at fair value, net of transaction costs other than for financial assets carried at fair value through the Income Statement.

The Group's financial assets are included in the Balance Sheet as current assets, except for those maturing more than twelve months after the balance sheet date, whereupon they are classified as non-current assets. The Group's financial assets comprise 'Trade and other receivables', 'Amounts recoverable on contracts' and 'Cash at bank and in hand' in the Balance Sheet.

### Loans and receivables

Trade receivables, amounts recoverable on contracts and cash at bank and in hand are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivables. Trade receivables and amounts recoverable on contracts are initially recorded at fair value net of transaction costs, being invoiced value less any provisional estimate for impairment should this be necessary due to a loss event. Trade receivables are subsequently remeasured at invoiced value, less an updated provision for impairment. Any change in their value through impairment or reversal of impairment is recognised in the Income Statement.

Provisions against trade receivables and amounts recoverable on contracts are made when objective evidence is received that the Group will not be able to collect all amounts due to it in accordance with the original terms of those receivables. The amount of the write down is determined as the difference between the asset's carrying amount and the present value of estimated future cash flows. Individually significant balances are reviewed separately for impairment based on the credit terms agreed with the customer. Other balances are grouped into credit risk categories and reviewed in aggregate.

Cash and cash equivalents include cash at bank and in hand and bank deposits available at less than 24 hours' notice. Bank overdrafts are presented as current liabilities to the extent that there is no right of offset with cash balances.

Following initial recognition, financial assets are subsequently remeasured at amortised cost using the effective interest rate method.

### Financial liabilities

The Group's financial liabilities are overdrafts, trade and other payables and finance leasing liabilities. They are included in the Balance Sheet line items 'Short-term borrowings and overdrafts', 'Non-current financial liabilities' and 'Trade and other payables'.

All interest related charges are recognised as an expense in 'Finance cost' in the Income Statement with the exception of those that are directly attributable to the construction of a qualifying asset which are capitalised as part of that asset.

Bank and other borrowings are initially recognised at fair value net of transaction costs. Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance revenue and finance costs. Borrowing costs are recognised as an expense in the period in which they are incurred with the exception of those which are directly attributable to the construction of a qualifying asset which are capitalised as part of that asset.

Finance lease liabilities are initially measured at the lower of the fair value of the leased property and the present value of the minimum lease payments as determined at the inception of the lease. The initial value is reduced by the capital element of lease repayments over the period of the lease.

Trade payables on normal terms are not interest bearing and are stated at their fair value on initial recognition and subsequently at amortised cost.

Contingent consideration is initially recognised at fair value and is subsequently measured at fair value through the Income Statement.

## Derivative financial instruments

The Group uses derivative financial instruments to hedge its exposure to interest rate risks arising from operational and financing activities.

Derivative financial instruments are recognised initially and subsequently at fair value, with mark-to-market movements recognised in the Income Statement except where cash flow hedge accounting is applied.

The fair value of interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

## Derivative financial instruments continued

In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments. Mark-to-market movements on these derivatives are shown in the Income Statement.

## Hedge accounting for interest rate swaps

Where an interest rate swap is designated as a hedge of the variability in cash flows of an existing or highly probable forecast loan interest payment, the effective part of any valuation gain or loss on the swap instrument is recognised in 'Other comprehensive income' in the hedging reserve. The cumulative gain or loss is removed from equity and recognised in the Income Statement at the same time as the hedged transaction. The ineffective part of any gain or loss is recognised in the Income Statement immediately.

When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer probable, the cumulative unrealised gain or loss recognised in equity is recognised in the Income Statement immediately.

## Nature and purpose of each reserve in equity

Share capital is determined using the nominal value of shares that have been issued.

Share premium represents the difference between the nominal value of shares issued and the total consideration received.

Equity-settled shared-based employee remuneration is credited to the share-based payment reserve until the related share options are exercised. Upon exercise the share-based payment reserve is transferred to retained earnings.

The hedging reserve represents the effective part of any gain or loss on a cash flow hedge which has not been removed from equity and recognised in the Income Statement.

The merger reserve relates to the difference between the nominal value and total consideration in respect of the acquisition of Careforce Group plc, Supporta plc and Morrison Facilities Services Limited where the Company was entitled to the merger relief offered by the Companies Act.

## Dividends

Dividend distributions payable to equity shareholders are included in 'Current financial liabilities' when the dividends are approved in a general meeting prior to the balance sheet date.

## Use of judgements and estimates

The preparation of financial statements requires management to make estimates and judgements that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reported period. The estimates and associated judgements are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources.

The estimates and underlying judgements are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In the preparation of these consolidated financial statements, estimates and judgements have been made by management concerning the selection of useful lives of property, plant and equipment, provisions necessary for certain liabilities, when to recognise revenue on long-term contracts, actuarial judgements, discount rates used within impairment reviews, the underlying share price volatility for valuing equity-based payments and other similar evaluations. Actual amounts could differ from those estimates.

### Critical judgements in applying the Group's accounting policies

Revenue recognition

Revenue is recognised based on the stage of completion of job or contract activity. As described in the Revenue section on pages 74 to 76, certain types of Social Housing pricing mechanisms and Care require minimal judgement; however, Social Housing lump sum contracts and construction contracts do require judgements and estimates to be made to determine the stage of completion and the expected outcome for the individual contract.

# Principal accounting policies – Group continued

## Use of judgements and estimates continued

**Joint arrangements**

The Group participates in a number of joint arrangements where control of the arrangement is shared with another party. A joint arrangement is classified as a joint operation or as a joint venture, depending on management's assessment of the legal form and substance of the arrangement.

The classification can have a material impact on the consolidated financial statements. The Group's share of assets, liabilities, revenue, expenses and cash flows of joint operations would be included in the consolidated financial statements on a line-by-line basis, whereas the Group's investment and share of results of joint ventures are shown within single line items in the Consolidated Balance Sheet and Consolidated Income Statement respectively.

**Key sources of estimation uncertainty**

Impairment of goodwill

Determining whether goodwill is impaired requires an estimate of the value in use of the CGUs to which goodwill has been allocated. The value-in-use calculation involves an estimate of the future cash flows of the CGUs and also the selection of appropriate discount rates to calculate present values. Future cash flows are estimated using the current one-year budget forecast, extrapolated for a future growth rate. The estimated growth rates are based on past experience and knowledge of the individual sector's markets. Changes in the estimated growth rate could result in variations to the carrying value of goodwill. The Directors consider that the estimates and judgements involved in determining the value in use of the Care CGU goodwill are the most significant and have therefore utilised the services of an external consultant to undertake this impairment review. The estimated cash flows and future growth rates are based on past experience and knowledge of the sector. The value in use is most sensitive to changes in the terminal growth rate, the explicit growth rate and the discount rate. The sensitivity to changes in these estimations is detailed in note 11.

Defined benefit liabilities

A number of key estimates have been made, which are given below, which are largely dependent on factors outside the control of the Group:

- inflation rates;
- mortality;
- discount rate; and
- salary and pension increases.

Details of the particular estimates used are included in the pensions note. Sensitivity analysis for these key estimates is included in note 25.

Where the Group has a contractual right to recover the costs of making good any deficit in the scheme, the fair value of that asset has been recognised and disclosed. The right to recover costs is limited to exclude situations where the Group causes the scheme to incur service costs in excess of those which would have been incurred were the members employed within Local Government. The Directors have made judgements in respect of whether any of the deficit is as a result of such situations.

The right to recover costs is also limited to situations where the cap on employer contributions to be suffered by the Group is not set so as to contribute to reducing the deficit in the scheme. The Directors, in conjunction with the scheme actuaries, have made judgements in respect of the predicted future service cost and contributions to the scheme to reflect this in the fair value of the asset recognised.

## New standards and interpretations not yet applied

Improvements to IFRS 2011–2013 Cycle. The Group is expected to apply these improvements for the Group's 31 December 2015 financial statements.

Accounting for Acquisitions of Interests in Joint Operations, Amendments to IFRS 11. The Group is expected to apply this amendment for the Group's 31 December 2016 financial statements.

Clarification of Acceptable Methods of Depreciation and Amortisation, Amendment to IAS 16 and IAS 38. The Group is expected to apply these amendments for the Group's 31 December 2016 financial statements.

IFRS 9 'Financial Instruments' specifies how an entity should classify and measure financial assets, including some hybrid contracts. The Group is expected to apply this standard for the Group's 31 December 2018 financial statements, subject to endorsement by the EU.

IFRS 15 'Revenue from Contracts with Customers'. This standard introduces a new revenue recognition model that recognises revenue either at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognised. The Group is expected to apply this standard for the Group's 31 December 2017 financial statements, subject to endorsement by the EU.

# Consolidated income statement

For the year ended 31 December 2014

| | Note | 2014 £'000 | 2013 £'000 |
|---|---|---|---|
| **Continuing operations** | | | |
| **Sales revenue** | 1 | **838,740** | 865,574 |
| Cost of sales | | **(613,699)** | (641,115) |
| **Gross profit** | | **225,041** | 224,459 |
| Other administrative expenses | | **(182,046)** | (183,344) |
| Exceptional costs | 6 | **—** | (6,663) |
| Amortisation of acquisition intangibles | 12 | **(12,328)** | (10,860) |
| **Total administrative costs** | | **(194,374)** | (200,867) |
| Operating profit before exceptional costs and amortisation of acquisition intangibles | | **42,995** | 41,115 |
| **Operating profit** | | **30,667** | 23,592 |
| Share of results of equity accounted joint ventures | | **299** | — |
| Finance income | 3 | **2,315** | 2,119 |
| Finance costs | 3 | **(3,604)** | (3,966) |
| Profit for the year before tax, exceptional costs and the amortisation of acquisition intangibles | | **42,005** | 39,268 |
| **Profit for the year before tax** | | **29,677** | 21,745 |
| Tax expense | 7 | **(4,442)** | (4,757) |
| **Profit for the year from continuing operations** | | **25,235** | 16,988 |
| **Discontinued operations** | | | |
| Loss for the year before exceptional costs and before tax from discontinued operations | 8 | **—** | (2,638) |
| Exceptional costs from discontinued operations | 8 | **—** | (18,830) |
| Tax income from discontinued operations | 8 | **—** | 3,307 |
| **Loss for the year after tax from discontinued operations** | | **—** | (18,161) |
| **Profit/(loss) for the year from continuing and discontinued operations** | | **25,235** | (1,173) |

| | Note | 2014 £'000 | 2013 £'000 |
|---|---|---|---|
| **Attributable to:** | | | |
| Owners of the parent | | **25,286** | (942) |
| Non-controlling interest | | **(51)** | (231) |
| **Profit/(loss) for the year** | | **25,235** | (1,173) |

| | Note | 2014 | 2013 |
|---|---|---|---|
| **Earnings per share** | | | |
| Basic | 10 | **25.03p** | (1.21p) |
| Diluted | 10 | **24.65p** | (1.17p) |

The accompanying accounting policies and notes form an integral part of these financial statements.

# Consolidated statement of comprehensive income

For the year ended 31 December 2014

| | Note | 2014 £'000 | 2013 £'000 |
|---|---|---|---|
| **Net profit/(loss) for the year** | | **25,235** | (1,173) |
| Other comprehensive income/(expense): | | | |
| Which will be subsequently reclassified to the Income Statement: | | | |
| Cash flow hedges: | | | |
| – (losses)/gains arising in the year | 20 | **(841)** | 593 |
| – reclassification to Income Statement | 20 | **722** | 791 |
| Increase/(decrease) in deferred tax asset in respect of cash flow hedges | 20 | **5** | (319) |
| Which will not be subsequently reclassified to the Income Statement: | | | |
| Actuarial loss on defined benefit pension scheme | 25 | **(3,290)** | (2,196) |
| Increase in deferred tax asset in respect of defined benefit pension schemes | 21 | **694** | 577 |
| Other comprehensive expense for the year | | **(2,710)** | (554) |
| Total comprehensive income/(expense) for the year | | **22,525** | (1,727) |

| | | |
|---|---|---|
| **Attributable to:** | | |
| Owners of the parent | **24,302** | (1,496) |
| Non-controlling interest | **(1,777)** | (231) |
| Total comprehensive income/(expense) for the year | **22,525** | (1,727) |

The accompanying accounting policies and notes form an integral part of these financial statements.

# Consolidated balance sheet

As at 31 December 2014

| | Note | 2014 £'000 | 2013 £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current** | | | |
| Goodwill | 11 | **192,003** | 157,945 |
| Intangible assets | 12 | **35,375** | 35,646 |
| Share of net asset of joint ventures | 14 | **1,856** | — |
| Property, plant and equipment | 13 | **15,880** | 15,068 |
| Pension and other employee benefits | 25 | **15,131** | 14,731 |
| Deferred tax asset | 21 | **8,573** | 10,570 |
| | | **268,818** | 233,960 |
| **Current** | | | |
| Inventories | 15 | **8,468** | 10,452 |
| Trade and other receivables | 16 | **142,616** | 151,693 |
| Cash at bank and in hand | | **66,634** | 79,552 |
| | | **217,718** | 241,697 |
| **Total assets** | | **486,536** | 475,657 |
| **Equity** | | | |
| **Equity attributable to the shareholders of Mears Group PLC** | | | |
| Called up share capital | 22 | **1,011** | 1,007 |
| Share premium account | | **56,714** | 56,082 |
| Share-based payment reserve | | **1,653** | 1,050 |
| Hedging reserve | | **(962)** | (848) |
| Merger reserve | | **46,214** | 46,214 |
| Retained earnings | | **92,179** | 77,366 |
| **Total equity shareholders' funds** | | **196,809** | 180,871 |
| Non-controlling interest | | **(2,347)** | (570) |
| **Total equity** | | **194,462** | 180,301 |
| **Liabilities** | | | |
| **Non-current** | | | |
| Long-term borrowing and overdrafts | 20 | **57,500** | 55,000 |
| Pension and other employee benefits | 25 | **8,372** | 6,107 |
| Deferred tax liabilities | 21 | **9,418** | 9,764 |
| Financial liabilities | 18 | **788** | 701 |
| Other liabilities | 19 | **25,956** | 1,278 |
| | | **102,034** | 72,850 |
| **Current** | | | |
| Short-term borrowings and overdrafts | 20 | **5,300** | 25,000 |
| Trade and other payables | 17 | **182,098** | 196,975 |
| Financial liabilities | 18 | **580** | 478 |
| Current tax liabilities | | **2,062** | 53 |
| **Current liabilities** | | **190,040** | 222,506 |
| **Total liabilities** | | **292,074** | 295,356 |
| **Total equity and liabilities** | | **486,536** | 475,657 |

The financial statements were approved and authorised for issue by the Board of Directors and were signed on its behalf on 17 March 2015.

**R Holt**
**Director**

**A C M Smith**
**Director**

**Company number: 03232863**

The accompanying accounting policies and notes form an integral part of these financial statements.

# Consolidated cash flow statement

For the year ended 31 December 2014

| | Note | 2014 £'000 | 2013 £'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Result for the year before tax | | **29,677** | 21,745 |
| Adjustments | 23 | **20,191** | 18,558 |
| Change in inventories | | **2,195** | 1,291 |
| Change in trade and other receivables | | **11,967** | 9,242 |
| Change in trade and other payables | | **(17,595)** | (11,920) |
| Cash inflow from operating activities of continuing operations before taxation | | **46,435** | 38,916 |
| Taxes paid | | **(2,285)** | (3,099) |
| Net cash inflow from operating activities of continuing operations | | **44,150** | 35,817 |
| Net cash outflow from operating activities of discontinued operations | | **—** | (3,632) |
| Net cash inflow from operating activities | | **44,150** | 32,185 |
| **Investing activities** | | | |
| Additions to property, plant and equipment | | **(3,962)** | (3,660) |
| Additions to other intangible assets | | **(1,484)** | (1,169) |
| Proceeds from disposals of property, plant and equipment | | **106** | 6 |
| Acquisition of subsidiary undertakings, net of cash | | **(22,221)** | (23,617) |
| Interest received | | **78** | 2 |
| Net cash outflow from investing activities of continuing operations | | **(27,483)** | (28,438) |
| Net cash outflow from investing activities of discontinued operations | | **—** | (1,390) |
| Net cash outflow from investing activities | | **(27,483)** | (29,828) |
| **Financing activities** | | | |
| Proceeds from share issue | | **636** | 21,260 |
| Discharge of finance lease liability | | **(62)** | — |
| Interest paid | | **(3,707)** | (3,565) |
| Dividends paid | | **(9,252)** | (8,116) |
| Net cash (outflow)/inflow from financing activities of continuing operations | | **(12,385)** | 9,579 |
| Net cash outflow from financing activities of discontinued operations | | **—** | — |
| Net cash (outflow)/inflow from financing activities | | **(12,385)** | 9,579 |
| Cash and cash equivalents, beginning of year | | **(448)** | (12,384) |
| Net increase in cash and cash equivalents | | **4,282** | 11,936 |
| **Cash and cash equivalents, end of year** | | **3,834** | (448) |
| Cash and cash equivalents comprises the following: | | | |
| – cash at bank and in hand | | **66,634** | 79,552 |
| – borrowings and overdrafts | | **(62,800)** | (80,000) |
| **Cash and cash equivalents** | | **3,834** | (448) |

The accompanying accounting policies and notes form an integral part of these financial statements.

# Consolidated statement of changes in equity

For the year ended 31 December 2014

| | Attributable to equity shareholders of the Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital £'000 | Share premium account £'000 | Share-based payment reserve £'000 | Hedging reserve £'000 | Merger reserve £'000 | Retained earnings £'000 | Non-controlling interest £'000 | Total equity £'000 |
| At 1 January 2013 | 919 | 34,910 | 1,685 | (1,913) | 46,214 | 87,342 | (339) | 168,818 |
| Net result for the year | — | — | — | — | — | (942) | (231) | (1,173) |
| Other comprehensive income/(expense) | — | — | — | 1,065 | — | (1,619) | — | (554) |
| Total comprehensive income/(expense) for the year | — | — | — | 1,065 | — | (2,561) | (231) | (1,727) |
| Deferred tax on share-based payments | — | — | — | — | — | (599) | — | (599) |
| Issue of shares | 88 | 21,172 | — | — | — | — | — | 21,260 |
| Share option charges | — | — | 665 | — | — | — | — | 665 |
| Exercise of share options | — | — | (1,300) | — | — | 1,300 | — | — |
| Dividends | — | — | — | — | — | (8,116) | — | (8,116) |
| At 1 January 2014 | 1,007 | 56,082 | 1,050 | (848) | 46,214 | 77,366 | (570) | 180,301 |
| Net result for the year | — | — | — | — | — | 25,286 | (51) | 25,235 |
| Other comprehensive expense | — | — | — | (114) | — | (870) | (1,726) | (2,710) |
| **Total comprehensive (expense)/income for the year** | — | — | — | (114) | — | 24,302 | (1,777) | 22,525 |
| Deferred tax on share-based payments | — | — | — | — | — | (418) | — | (418) |
| Issue of shares | 4 | 632 | — | — | — | — | — | 636 |
| Share option charges | — | — | 670 | — | — | — | — | 670 |
| Exercise of share options | — | — | (67) | — | — | 67 | — | — |
| Dividends | — | — | — | — | — | (9,252) | — | (9,252) |
| **At 31 December 2014** | **1,011** | **56,714** | **1,653** | **(962)** | **46,214** | **92,179** | **(2,347)** | **194,462** |

The accompanying accounting policies and notes form an integral part of these financial statements.

# Notes to the financial statements – Group

For the year ended 31 December 2014

## 1. Segment reporting

Segment information is presented in respect of the Group's operating segments. Segments are determined by reference to the internal reports reviewed by the Board.

The Group operated two operating segments during the year:

- Social Housing – services within this sector comprise a full repairs and maintenance service to Local Authorities and other Registered Social Landlords; and
- Care – services within this sector comprise personal care services to people in their own homes.

All of the Group's activities are carried out within the United Kingdom and the Group's principal reporting to its chief operating decision maker is not segmented by geography.

The principal financial measures used by the chief operating decision maker and the Board to review the performance of the operating segments are that of revenue growth and operating margins in both the core divisions of Social Housing and Care. The operating result utilised within the key performance measures is stated before amortisation of acquisition intangibles, exceptional costs and costs relating to the long-term incentive plans.

| | **2014** | | | 2013 | | |
|---|---|---|---|---|---|---|
| Operating segments | **Social Housing £'000** | **Care £'000** | **Total £'000** | Social Housing £'000 | Care £'000 | Total £'000 |
| Revenue | **714,733** | **124,007** | **838,740** | 742,479 | 123,095 | 865,574 |
| **Operating result pre amortisation of acquisition intangibles, exceptional costs and long-term incentive plans** | **34,410** | **9,641** | **44,051** | 33,530 | 9,623 | 43,153 |
| Operating margin pre amortisation of acquisition intangibles, exceptional costs and long-term incentive plans | **4.81%** | **7.78%** | **5.25%** | 4.52% | 7.82% | 4.99% |
| Long-term incentive plans | **(1,056)** | **—** | **(1,056)** | (2,038) | — | (2,038) |
| **Operating result pre amortisation of acquisition intangibles and exceptional costs** | **33,354** | **9,641** | **42,995** | 31,492 | 9,623 | 41,115 |
| Exceptional costs | | | **—** | | | (6,663) |
| Amortisation of acquisition intangibles | | | **(12,328)** | | | (10,860) |
| Finance costs, net | | | **(990)** | | | (1,847) |
| Tax expense | | | **(4,442)** | | | (4,757) |
| **Profit for the year from continuing activities** | | | **25,235** | | | 16,988 |

All revenue and all non-current assets arise within the United Kingdom. All of the revenue reported is external to the Group. No revenue in respect of a single customer comprises more than 10% of the total revenue reported.

## 1. Segment reporting continued

In addition, the following disclosures have been provided in respect of segmental analysis required by IFRS 8 'Operating Segments':

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| Operating segments | Social Housing £'000 | Care £'000 | Other £'000 | Total £'000 | Social Housing £'000 | Care £'000 | Other £'000 | Total £'000 |
| Segment assets | 365,824 | 120,712 | — | 486,536 | 349,860 | 125,797 | — | 475,657 |
| Segment liabilities | (237,474) | (54,600) | — | (292,074) | (238,975) | (56,381) | — | (295,356) |
| Property, plant and equipment additions | 4,203 | 333 | — | 4,536 | 3,762 | 431 | 22 | 4,215 |
| Depreciation | 3,631 | 731 | — | 4,362 | 4,128 | 620 | 176 | 4,924 |
| Amortisation of acquisition intangibles | 6,069 | 6,259 | — | 12,328 | 5,955 | 4,905 | — | 10,860 |
| Share of result of joint venture | 299 | — | — | 299 | — | — | — | — |
| Finance income | 2,303 | 12 | — | 2,315 | 2,051 | 68 | 85 | 2,204 |
| Finance costs | (1,942) | (1,662) | — | (3,604) | (2,596) | (1,370) | — | (3,966) |
| Profit/(loss) before tax | 27,945 | 1,732 | — | 29,677 | 18,329 | 3,416 | (21,468) | 277 |

## 2. Operating costs

Operating costs, relating to continuing activities, include:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Share-based payments | 670 | 665 |
| Long-term incentives | 386 | 1,373 |
| Depreciation | 4,362 | 4,748 |
| Amortisation | 13,480 | 11,904 |
| Loss on disposal of property, plant and equipment | (3) | (215) |
| Hire of plant and machinery | 5,916 | 4,944 |
| Other operating lease rentals | 24,705 | 24,644 |

Fees payable for audit and non-audit services during the year were as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Fees payable to the auditor for the audit of the Group's financial statements | 58 | 56 |
| Other fees payable to the auditor in respect of: | | |
| – auditing of accounts of subsidiary undertakings pursuant to legislation | 228 | 214 |
| – taxation compliance fees | 45 | 33 |
| – taxation advice fees | 16 | 17 |
| – internal audit effectiveness review | — | 25 |
| Total auditor's remuneration | 347 | 345 |

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 3. Finance income and finance costs

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Interest charge on overdrafts and short-term loans | **(1,975)** | (2,401) |
| Interest charge on hedged items (effective hedges) | **(722)** | (791) |
| Interest charge on hedged items (ineffective hedges) | **(70)** | — |
| Other interest | **(80)** | — |
| Finance costs on bank loans, overdrafts and finance leases | **(2,847)** | (3,192) |
| Interest charge on defined benefit asset | **(426)** | (401) |
| Unwinding of discounting | **(331)** | (373) |
| **Total finance costs** | **(3,604)** | (3,966) |
| Interest income resulting from short-term bank deposits | **10** | 2 |
| Interest income resulting from defined benefit asset | **2,238** | 2,117 |
| Other interest income | **67** | — |
| **Finance income** | **2,315** | 2,119 |
| Net finance charge on continuing operations | **(1,289)** | (1,847) |
| Net finance income on discontinued operations | **—** | 85 |
| Net finance charge | **(1,289)** | (1,762) |
| **Gains and losses on hedged items recognised in other comprehensive income** | | |
| (Losses)/gains arising in the year | **(841)** | 593 |
| Reclassification to the Income Statement | **722** | 791 |
| Changes in mark-to-market of interest rate swaps (effective hedges) | **(119)** | 1,384 |

## 4. Employees

Staff costs during the year were as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Wages and salaries | **262,730** | 274,617 |
| Social security costs | **22,061** | 23,968 |
| Other pension costs | **11,387** | 10,450 |
| Total continuing operations | **296,178** | 309,035 |
| Discontinued operations | **—** | 5,181 |
| Total continuing and discontinued operations | **296,178** | 314,216 |

## 4. Employees continued

The average number of employees of the Group during the year was:

| | 2014 Number | 2013 Number |
|---|---|---|
| Site workers | **4,133** | 4,358 |
| Carers | **5,944** | 6,060 |
| Office and management | **2,888** | 2,974 |
| Total continuing operations | **12,965** | 13,392 |
| Discontinued operations | **—** | 140 |
| Total continuing and discontinued operations | **12,965** | 13,532 |

Remuneration in respect of Directors was as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Emoluments | **2,189** | 2,190 |
| Gains made on the exercise of share options | **536** | 5,139 |
| Pension contributions to personal pension schemes | **185** | 185 |
| | **2,910** | 7,514 |

During the year contributions were paid to personal pension schemes for four Directors (2013: four).

During the year two Directors (2013: three) exercised share options.

## 5. Share-based employee remuneration

As at 31 December 2014 the Group maintained five share-based payment schemes for employee remuneration.

Details of the share options outstanding are as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Number '000 | Weighted average exercise price p | Number '000 | Weighted average exercise price p |
| Outstanding at 1 January | **2,420** | **40** | 5,186 | 63 |
| Granted | **1,205** | **414** | 524 | 1 |
| Forfeited/lapsed | **(159)** | **260** | (856) | 28 |
| Exercised | **(472)** | **135** | (2,434) | 86 |
| Outstanding at 31 December | **2,994** | **223** | 2,420 | 40 |

The weighted average share price at the date of exercise for share options exercised during the period was £1.35. At 31 December 2014, 1.3m options had vested and were still exercisable at prices between 1p and 414p. These options had a weighted average exercise price of 144p and a weighted average remaining contractual life of seven years.

The fair values of options granted were determined using the Binomial and Monte Carlo option pricing models. Significant inputs into the calculation include the market price at the date of grant and exercise prices. Furthermore, the calculation takes into account the future dividend yield, the share price volatility rate and the risk-free interest rate.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 5. Share-based employee remuneration continued

The underlying expected share price volatility was determined by reference to historical data. The Company expects the volatility of its share price to reduce as it matures. The risk-free interest rate was determined by the implied yield available on a zero-coupon Government bond at the date of grant. Adjustments are made to reflect expected and actual forfeitures during the vesting period due to failure to satisfy service conditions. In the case of the SAYE scheme the expected forfeitures take account of the requirement to save throughout the life of the scheme. There were 1.2m options granted during the year and 0.2m options lapsed during the year. The market price at 31 December 2014 was 375.5p and the range during 2014 was 326p to 525p.

All share-based employee remuneration will be settled in equity. The Group has no legal obligation to repurchase or settle the options.

The Group recognises the following expenses related to share-based payments:

| | **2014 £'000** | 2013 £'000 |
|---|---|---|
| LTIP | **(134)** | 202 |
| SAYE | **146** | 79 |
| Share Plan | **658** | 384 |
| | **670** | 665 |

In total, £0.7m of employee remuneration expense has been included in the Consolidated Income Statement for 2014 (2013: £0.7m), which gave rise to additional share-based payment reserves. No liabilities were recognised due to share-based payment transactions.

### The Mears Group PLC Long-term Incentive Plan (LTIP)

The LTIP was introduced in October 2008 following shareholder approval. The award of options is offered to a small number of key senior management. The principal terms of the LTIP are detailed below:

Principal terms of LTIP

| | |
|---|---|
| Number of options | Maximum award limit under the plan will be 200% of salary p.a. |
| Exercise price | 1p |
| Performance period | 3 years |
| Performance conditions | There are two performance targets attaching to the LTIP Award. |
| | 75% of the LTIP Award will relate to an EPS growth target. The other 25% of the LTIP Award relates to the Company's TSR against the return of the FTSE All Share Support Services Sector. |
| Expiry conditions | Options are forfeited if the employee leaves the Group before the options have vested. |

Performance conditions of LTIP (2010 issue)

| EPS growth target | | TSR target | |
|---|---|---|---|
| Performance levels | Level of vesting | Performance levels | Level of vesting |
| 8.0% | 10% | Below index return | 0% |
| 10.0% | 30% | Equal to index | 30% |
| 12.5% | 100% | 10% outperformance of the index p.a. | 100% |

## 5. Share-based employee remuneration continued

**Approved share option plan**

Options are exercisable at a price equal to the average quoted market price of the Company's shares on the three dealing days prior to the date of grant. The vesting period is three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves Mears before the options vest.

**Unapproved share option plan**

Options are exercisable at a price equal to the average quoted market price of the Company's shares on the three dealing days prior to the date of grant. The vesting period is three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves Mears before the options vest. With the introduction of the LTIP in 2008, the Remuneration Committee has decided that no further awards will be made under the unapproved share option plan.

**Save As You Earn (SAYE) scheme**

Options are available to all employees. Options are granted for a period of either three or five years. Options are exercisable at a price based on the quoted market price of the Company's shares at the time of invitation, discounted by up to 20%. Options are forfeited if the employee leaves Mears Group before the options vest which impacts on the number of options expected to vest. If an employee stops saving but continues in employment, this is treated as a cancellation which results in an acceleration of the share-based payment charge.

**Special Incentive Plan 2007 (SIP)**

The SIP was introduced in 2007 to reward the then Chief Executive Officer, Bob Holt, with premium priced options linked to long-term performance. The terms and conditions were subsequently amended on 3 July 2009. If the options remain unexercised after a period of ten years from the date of grant, the options expire. There was a single award and no further awards will be made under this plan.

**The Mears Group PLC Share Plan (2013)**

The Share Plan was introduced in June 2013 following shareholder approval. The award of options is offered to a small number of key senior management. The principal terms of the LTIP are detailed below:

Principal terms of LTIP

| | |
|---|---|
| Number of options | Maximum award limit under the plan will be 200% of salary p.a. |
| Exercise price | 1p |
| Vesting period | Three-year (future awards under this plan will be subject to a five-year vesting period). |
| Performance conditions | None |
| Expiry conditions | Options are forfeited if the employee leaves the Group before the options have been vested. |

## 6. Exceptional costs

Exceptional costs incurred in the period which are considered non-trading or non-recurring in nature are detailed below:

| | **2014 £'000** | 2013 £'000 |
|---|---|---|
| Costs of acquisitions | — | 200 |
| Costs of integration | — | 6,463 |
| Total continuing operations | — | 6,663 |
| Total discontinued operations (see note 8) | — | 18,830 |
| Total continuing and discontinued operations | — | 25,493 |

The costs of acquisition in the prior period relate to the acquisition of ILS Group Limited.

The costs of integration in the prior period relate to the integration of the Morrison and Mears Social Housing businesses.

Exceptional costs on discontinued activities in the prior period relate to the loss on disposal and associated costs of disposals of Haydon Mechanical & Electrical Limited.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 7. Tax expense

**Tax recognised in the Income Statement**

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| United Kingdom corporation tax effective rate 18.2% (2013: 15.5%) | **5,410** | 3,360 |
| Adjustment in respect of previous periods | **(721)** | (23) |
| Total current tax recognised in Income Statement | **4,689** | 3,337 |
| Deferred taxation charge: | | |
| – on defined benefit pension obligations | **285** | 533 |
| – on share-based payments | **(130)** | 524 |
| – on accelerated capital allowances | **293** | (200) |
| – on amortisation of acquisition intangibles | **(2,127)** | (2,364) |
| – on short-term temporary timing differences | **2,285** | 178 |
| – on corporate tax losses | **(674)** | 2,655 |
| – impact of change in statutory tax rates | **(179)** | 94 |
| Total deferred taxation recognised in Income Statement | **(247)** | 1,420 |
| Total tax expense recognised in Income Statement on continuing operations | **4,442** | 4,757 |
| Total tax credit recognised in Income Statement on discontinued operations | **—** | (3,307) |
| Total tax expense recognised in Income Statement | **4,442** | 1,450 |

The charge for the year can be reconciled to the result for the year as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Results for the year before tax | **29,677** | 21,745 |
| Result for the year multiplied by standard rate of corporation tax in the United Kingdom for the period of 21.50% (2013: 23.25%) | **6,381** | 5,056 |
| Effect of: | | |
| – expenses not deductible for tax purposes | **473** | 687 |
| – depreciation in excess of capital allowances | **302** | 71 |
| – tax relief on exercise of share options | **(275)** | (1,127) |
| – statutory tax rate changes | **(179)** | 93 |
| – small company tax rate | **(6)** | — |
| – tax losses included within loss from discontinued operations | **—** | (3,307) |
| – temporary timing differences not previously recognised in deferred tax | **(773)** | — |
| – tax losses not previously recognised in deferred tax | **(760)** | — |
| – adjustment in respect of prior periods | **(721)** | (23) |
| Actual tax expense | **4,442** | 1,450 |

## 7. Tax expense continued

**Tax recognised in the Income Statement** continued

The following tax has been charged to other comprehensive income or equity during the year:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Deferred tax recognised in other comprehensive income** | | |
| – on defined benefit pension obligations | **(658)** | (461) |
| – on cash flow hedges | **(38)** | 269 |
| – impact of change in statutory tax rates | **(3)** | (66) |
| Total deferred taxation recognised in other comprehensive income | **(699)** | (258) |
| **Deferred tax recognised directly in equity** | | |
| Deferred taxation charge: | | |
| – on share-based payments | **(359)** | 425 |
| – impact of change in statutory tax rates | **(59)** | 174 |
| Total deferred taxation recognised in equity | **(418)** | 599 |
| **Total tax** | | |
| Total current tax | **4,689** | 30 |
| Total deferred tax | **(1,364)** | 1,761 |

## 8. Discontinued operations

On 5 November 2013 the Group entered into a sale agreement to dispose of Haydon Mechanical & Electrical Limited, which undertook design and build M&E services. The disposal was completed on 21 November 2013. The results of the operations, which have been included in the consolidated financial statements, are as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Sales revenue | **—** | 32,632 |
| Cost of sales | **—** | (29,131) |
| Administrative expenses | **—** | (6,224) |
| Finance income, net | **—** | 85 |
| Loss for the year before tax on discontinued operations | **—** | (2,638) |
| Loss on disposal and other associated costs | **—** | (18,830) |
| Tax on discontinued operations | **—** | 3,307 |
| Tax on loss on disposal | **—** | — |
| Loss for the year after tax on discontinued operations | **—** | (18,161) |

Operating costs include:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Depreciation | **—** | 176 |
| Amortisation | **—** | 202 |
| Loss on disposal of property, plant and equipment | **—** | — |
| Hire of plant and machinery | **—** | 117 |
| Other operating lease rentals | **—** | 644 |

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

The loss on disposal in respect of discontinued activities is all attributable to the equity holders of the parent.

## 9. Dividends

The following dividends were paid on ordinary shares in the year:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Final 2013 dividend of 6.30p (2013: final 2012 dividend of 5.70p) per share | **6,370** | 5,617 |
| Interim 2014 dividend of 2.85p (2013: interim 2013 dividend of 2.50p) per share | **2,882** | 2,499 |
| | **9,252** | 8,116 |

The proposed final 2014 dividend of 7.15p per share has not been included within the consolidated financial statements as no obligation existed at 31 December 2014.

## 10. Earnings per share

| | Basic (continuing) | | Basic (discontinued) | | Basic (continuing and discontinued) | |
|---|---|---|---|---|---|---|
| | 2014 p | 2013 p | 2014 p | 2013 p | 2014 p | 2013 p |
| Earnings per share | **25.03** | 17.50 | **—** | (18.71) | **25.03** | (1.21) |
| Effect of amortisation of acquisition intangibles | **12.20** | 11.19 | **—** | — | **12.20** | 11.19 |
| Effect of full tax adjustment | **(4.54)** | (2.91) | **—** | 1.74 | **(4.54)** | (1.17) |
| Effect of exceptional costs (including tax impact) | **—** | 5.26 | **—** | 14.89 | **—** | 20.15 |
| Normalised earnings/(loss) per share | **32.69** | 31.04 | **—** | (2.08) | **32.69** | 28.96 |

| | Diluted (continuing) | | Diluted (discontinued) | | Diluted (continuing and discontinued) | |
|---|---|---|---|---|---|---|
| | 2014 p | 2013 p | 2014 p | 2013 p | 2014 p | 2013 p |
| Earnings per share | **24.65** | 16.96 | **—** | (18.13) | **24.65** | (1.17) |
| Effect of amortisation of acquisition intangibles | **12.02** | 10.84 | **—** | — | **12.02** | 10.84 |
| Effect of full tax adjustment | **(4.47)** | (2.82) | **—** | 1.68 | **(4.47)** | (1.14) |
| Effect of exceptional costs (including tax impact) | **—** | 5.10 | **—** | 14.43 | **—** | 19.53 |
| Normalised earnings/(loss) per share | **32.20** | 30.08 | **—** | (2.02) | **32.20** | 28.06 |

A normalised EPS is disclosed in order to show performance undistorted by amortisation of intangibles. The Group defines normalised earnings as excluding the amortisation of acquisition intangibles, exceptional costs and adjusted to reflect a full tax charge. The profit attributable to shareholders before and after adjustments for both basic and diluted EPS is:

| | Normalised (continuing) | | Normalised (discontinued) | | Normalised (continuing and discontinued) | |
|---|---|---|---|---|---|---|
| | 2014 £'000 | 2013 £'000 | 2014 £'000 | 2013 £'000 | 2014 £'000 | 2013 £'000 |
| Profit/(loss) attributable to shareholders: | **25,286** | 16,988 | **—** | (18,161) | **25,286** | (1,173) |
| – amortisation of acquisition intangibles | **12,328** | 10,860 | **—** | — | **12,328** | 10,860 |
| – full tax adjustment | **(4,588)** | (2,824) | **—** | 1,685 | **(4,588)** | (1,139) |
| – exceptional costs (including tax impact) | **—** | 5,114 | **—** | 14,452 | **—** | 19,566 |
| Normalised earnings/(loss) | **33,026** | 30,138 | **—** | (2,024) | **33,026** | 28,114 |

## 10. Earnings per share continued

The calculation of EPS is based on a weighted average of ordinary shares in issue during the year. The diluted EPS is based on a weighted average of ordinary shares calculated in accordance with IAS 33 'Earnings Per Share', which assumes that all dilutive options will be exercised. The additional normalised basic and diluted EPS use the same weighted average number of shares as the basic and diluted EPS.

| | **2014 Millions** | 2013 Millions |
|---|---|---|
| Weighted average number of shares in issue: | **101.02** | 97.09 |
| – dilutive effect of share options | **1.54** | 3.10 |
| Weighted average number of shares for calculating diluted earnings per share | **102.56** | 100.19 |

## 11. Goodwill

| | Goodwill arising on consolidation £'000 | Purchased goodwill £'000 | Total £'000 |
|---|---|---|---|
| **Gross carrying amount** | | | |
| At 1 January 2013 | 137,963 | 406 | 138,369 |
| Additions | 19,576 | — | 19,576 |
| At 1 January 2014 | 157,539 | 406 | 157,945 |
| Additions | 33,438 | — | 33,438 |
| Revisions | 620 | — | 620 |
| **At 31 December 2014** | **191,597** | **406** | **192,003** |
| **Accumulated impairment losses** | | | |
| At 1 January 2013, at 1 January 2014 and at 31 December 2014 | — | — | — |
| **Carrying amount** | | | |
| **At 31 December 2014** | **191,597** | **406** | **192,003** |
| At 31 December 2013 | 157,539 | 406 | 157,945 |

Goodwill on consolidation arises on the excess of cost of acquisition over the fair value of the net assets acquired on purchase of a company.

Purchased goodwill arises on the excess of cost of acquisition over the fair value of the net assets acquired on the purchase of the trade and assets of a business by the Company.

Additions to goodwill arising on consolidation are detailed within note 24.

The revision to the goodwill additions in the prior year totalling £0.6m relates to liabilities not accrued at the time of the acquisition. The revisions are not considered sufficiently material to warrant the restatement of the prior year balances.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 11. Goodwill continued

Goodwill is not amortised but is reviewed for impairment on an annual basis or more frequently if there are any indications that goodwill may be impaired. Goodwill acquired in a business combination is allocated to groups of CGUs according to the level at which management monitors that goodwill. Goodwill is carried at cost less accumulated impairment losses.

The carrying value of goodwill is allocated to the following CGUs:

| | Goodwill arising on consolidation £'000 | Purchased goodwill £'000 | Total £'000 |
|---|---|---|---|
| Social Housing | 93,585 | 406 | 93,991 |
| Care | 98,012 | — | 98,012 |
| | **191,597** | **406** | **192,003** |

An asset is impaired if its carrying value exceeds the unit's recoverable amount which is based upon value in use. At 31 December 2014 impairment reviews were performed by comparing the carrying value of the CGU with the value in use of the CGUs to which goodwill has been allocated. The value in use is calculated based upon the cash flow projections of the latest one-year budget forecast extrapolated for a further four years by a growth rate applicable to each unit and an appropriate terminal growth rate perpetuity.

The rates used were as follows:

| | Post tax discount rate | Pre tax discount rate | Growth rates (year 1) | Growth rates (years 2–3) | Growth rates (years 4–5) | Terminal growth rate |
|---|---|---|---|---|---|---|
| Social Housing | 9.2% | 10.9% | 5.0% | 5.0% | 5.0% | 2.5% |
| Care | 9.0% | 10.7% | 9.7% | 8.7% | 6.2% | 2.5% |

The estimated growth rates are based on past experience and knowledge of the individual sector's markets and represent management's base level expectations for future growth.

**Social Housing**

The contracts awarded within the Social Housing area are significant in size and the contract terms are typically three to ten years in duration. The record of Mears in retaining contracts on expiry is typically over 90%. The impairment reviews have always taken a particularly prudent stance and incorporated a terminal growth assumption of 2.5%, which, whilst marginally higher than the UK long-term growth rate of 2.25%, is supported by historic organic growth.

Budgeted operating profits during the budget period are estimated by reference to the average operating margins achieved in the period immediately before the start of the budget period. There is no inclusion for any anticipated efficiency improvements.

The Directors consider that reasonably possible changes in these key assumptions would not cause a unit's carrying amount to exceed its recoverable amount.

## 11. Goodwill continued

### Care

The care-at-home market will continue to present strong growth opportunities. The Directors believe that future growth is underpinned by a number of factors including:

- the number of people aged over 65, who make up the bulk of Care expenditure, is forecast to grow, with the number of people over the age of 65 forecast to make up 24% of the population in 2036 compared to 17.5% in 2012. This is a rise of about 6.3m people;
- the NHS is tasked with investing more in Continuing Health Care (CHC) spend in the community and with joining up its services with Social Care. The community health service market was worth £1.1 billion in 2010 and is expected to rise to £2.0 billion by 2015. This represents a compound average growth rate of 12.7%. There are an increasing number of areas with joint commissioning between the NHS and Social Care, with the newly established health and wellbeing boards being encouraged to continue this process of integration against clearly agreed local priorities. A £3.8 billion 'Better Care Fund' is being set aside from within NHS budgets, to specifically support integrated health and social care work, such as around hospital discharge work and palliative care;
- residential care remains a more expensive solution and one that is generally less preferred by service users. Given the considerable financial challenges facing the UK economy, care at home will benefit from this situation;
- continued policy directives, referencing the Dilnot Report, are supporting increased spend on care services, the most recent announcement being a £72,000 cap on the amount an individual will have to spend on funding their own care in the future. This will enable the development of more cost effective insurance products for those people wanting to protect themselves against paying for their own care in the future;
- there is rising political concern about the current under funding of the sector, which management believes will lead to further funding announcements in the future; and
- a little over 10% of the market continues to be delivered by Local Authority in-house services; however, in parts of the United Kingdom, notably Scotland, this is as high as 50%. Mears has been growing its presence within the areas which currently have high levels of in-sourcing. Given the lower costs within the private sector, further outsourcing is very likely.

The Directors also foresee significant growth opportunities in the higher acuity space and have recently recruited around ten technical lead specialists to pursue opportunities in this field. The Directors expect to see higher acuity revenue growth of about 20% per year in the immediate future.

The impairment reviews have incorporated growth rates as detailed in the table on page 96.

Budgeted operating profits during the budget period are estimated by reference to the average operating margins achieved in the period immediately before the start of the budget period. There is no inclusion for any anticipated efficiency improvements.

The Directors consider that the Care value in use is most sensitive to changes in the terminal growth rate. The sensitivity of the calculated value in use to changes in explicit growth rate, terminal growth rate and discount rate is shown in the table overleaf. The red values indicate situations which would result in impairment.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 11. Goodwill continued

**Care** continued

The table below shows the sensitivity of the headroom (£'000) to simultaneous changes in the discount rate and the long-term growth rate.

| | Discount rate | | | | | | |
|---|---|---|---|---|---|---|---|
| Long-term growth rate | 8.25% | 8.50% | 8.75% | 9.00% | 9.25% | 9.50% | 9.75% |
| 0.50% | (1,424) | (4,955) | (8,270) | (11,389) | (14,328) | (17,102) | (19,725) |
| 1.00% | 4,003 | 69 | (3,609) | (7,057) | (10,294) | (13,339) | (16,208) |
| 1.50% | 10,235 | 5,811 | 1,694 | (2,147) | (5,739) | (9,105) | (12,265) |
| 2.00% | 17,463 | 12,436 | 7,784 | 3,464 | (556) | (4,306) | (7,814) |
| 2.50% | 25,949 | 20,166 | 14,847 | **9,939** | 5,395 | 1,178 | (2,748) |
| 3.00% | 36,051 | 29,301 | 23,139 | 17,492 | 12,299 | 7,505 | 3,069 |
| 3.50% | 48,279 | 40,263 | 33,011 | 26,419 | 20,402 | 14,888 | 9,815 |
| 4.00% | 63,385 | 53,660 | 44,960 | 37,132 | 30,050 | 23,612 | 17,736 |
| 4.50% | 82,519 | 70,408 | 59,722 | 50,224 | 41,728 | 34,082 | 27,165 |

The table below shows sensitivity of the headroom (£'000) to simultaneous changes in the discount rate and EBITA margin.

| | Discount rate | | | | | | |
|---|---|---|---|---|---|---|---|
| EBITA | 8.25% | 8.50% | 8.75% | 9.00% | 9.25% | 9.50% | 9.75% |
| 5.00% | (6,995) | (11,073) | (14,827) | (18,296) | (21,509) | (24,495) | (27,278) |
| 5.50% | 1,241 | (3,263) | (7,409) | (11,237) | (14,783) | (18,077) | (21,145) |
| 6.00% | 9,477 | 4,546 | 10 | (4,178) | (8,057) | (11,659) | (15,013) |
| 6.50% | 17,713 | 12,356 | 7,428 | 2,880 | (1,331) | (5,241) | (8,880) |
| 7.00% | 25,949 | 20,166 | 14,847 | **9,939** | 5,395 | 1,178 | (2,748) |
| 7.50% | 34,185 | 27,976 | 22,266 | 16,997 | 12,122 | 7,596 | 3,385 |
| 8.00% | 42,421 | 35,785 | 29,684 | 24,056 | 18,848 | 14,014 | 9,517 |
| 8.50% | 50,656 | 43,595 | 37,103 | 31,115 | 25,574 | 20,433 | 15,650 |
| 9.00% | 58,892 | 51,405 | 44,522 | 38,173 | 32,300 | 26,851 | 21,782 |

The table below shows sensitivity of the headroom (£'000) to simultaneous changes in the long-term growth rate and EBITA margin.

| | Long-term growth rate | | | | | | |
|---|---|---|---|---|---|---|---|
| EBITA | 1.00% | 1.50% | 2.00% | 2.50% | 3.00% | 3.50% | 4.00% |
| 5.00% | (29,661) | (26,378) | (22,625) | (18,296) | (13,244) | (7,274) | (110) |
| 5.50% | (24,010) | (20,320) | (16,103) | (11,237) | (5,560) | 1,149 | 9,200 |
| 6.00% | (18,359) | (14,262) | (9,580) | (4,178) | 2,124 | 9,573 | 18,511 |
| 6.50% | (12,708) | (8,205) | (3,058) | 2,880 | 9,808 | 17,996 | 27,821 |
| 7.00% | (7,057) | (2,147) | 3,464 | **9,939** | 17,492 | 26,419 | 37,132 |
| 7.50% | (1,405) | 3,911 | 9,987 | 16,997 | 25,176 | 34,843 | 46,442 |
| 8.00% | 4,246 | 9,969 | 16,509 | 24,056 | 32,861 | 43,266 | 55,752 |
| 8.50% | 9,897 | 16,026 | 23,032 | 31,115 | 40,545 | 51,689 | 65,063 |
| 9.00% | 15,548 | 22,084 | 29,554 | 38,173 | 48,229 | 60,113 | 74,373 |

## 12. Other intangible assets

| | Acquisition intangibles | | | Other intangibles | | | |
|---|---|---|---|---|---|---|---|
| | Client relationships £'000 | Order book £'000 | Total acquisition intangibles £'000 | Development expenditure £'000 | Intellectual property £'000 | Total other intangibles £'000 | Total intangibles £'000 |
| **Gross carrying amount** | | | | | | | |
| At 1 January 2013 | 58,744 | 13,549 | 72,293 | 5,190 | 224 | 5,414 | 77,707 |
| Acquired on acquisition | 2,552 | 4,551 | 7,103 | — | — | — | 7,103 |
| Additions | — | — | — | 1,169 | — | 1,169 | 1,169 |
| Disposal of subsidiary | — | — | — | (173) | — | (173) | (173) |
| At 1 January 2014 | 61,296 | 18,100 | 79,396 | 6,186 | 224 | 6,410 | 85,806 |
| Acquired on acquisition | 10,465 | 1,260 | 11,725 | — | — | — | 11,725 |
| Additions | — | — | — | 1,484 | — | 1,484 | 1,484 |
| Disposals | — | — | — | (315) | — | (315) | (315) |
| **At 31 December 2014** | **71,761** | **19,360** | **91,121** | **7,355** | **224** | **7,579** | **98,700** |
| **Accumulated amortisation** | | | | | | | |
| At 1 January 2013 | 26,826 | 9,150 | 35,976 | 2,188 | 178 | 2,366 | 38,342 |
| Amortisation charge for period | 8,600 | 2,260 | 10,860 | 1,046 | 46 | 1,092 | 11,952 |
| Disposal of subsidiary | — | — | — | (134) | — | (134) | (134) |
| At 1 January 2014 | 35,426 | 11,410 | 46,836 | 3,100 | 224 | 3,324 | 50,160 |
| Amortisation charge for period | 5,926 | 6,402 | 12,328 | 1,152 | — | 1,152 | 13,480 |
| Disposals | — | — | — | (315) | — | (315) | (315) |
| **At 31 December 2014** | **41,352** | **17,812** | **59,164** | **3,937** | **224** | **4,161** | **63,325** |
| **Carrying amount** | | | | | | | |
| **At 31 December 2014** | **30,409** | **1,548** | **31,957** | **3,418** | **—** | **3,418** | **35,375** |
| At 31 December 2013 | 25,870 | 6,690 | 32,560 | 3,086 | — | 3,086 | 35,646 |

Development expenditure relates to the development of the Group's Social Housing job management system and the Group's Care management system. Development expenditure is amortised over its useful economic life of 5.0 years. The weighted average remaining economic life of the asset is 3.4 years (2013: 3.6 years).

Intellectual property is amortised over its useful economic life of 5.0 years.

Amortisation of development expenditure is included within other administrative expenses. Amortisation of acquisition intangibles is presented separately.

The value placed on the order book is based upon the cash flow projections over the contracts in place when a business is acquired. Due to uncertainties with trying to forecast revenues beyond the contract term, the Directors have taken a measure of conservatism and value contracts over the contractual term only. The value of the order book is amortised over its remaining life.

The value placed on the customer relationships are based upon the non-contractual expected cash inflows. These cash flow projections assume a customer attrition rate of 5% based upon three-year historic trends.

Additions to intangible assets arising on acquisition are detailed within note 24.

# Notes to the financial statements – Group continued
For the year ended 31 December 2014

## 13. Property, plant and equipment

| | Freehold property £'000 | Leasehold improvements £'000 | Plant and machinery £'000 | Fixtures, fittings and equipment £'000 | Motor vehicles £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| **Gross carrying amount** | | | | | | |
| At 1 January 2013 | — | 9,478 | 5,062 | 39,998 | 1,223 | 55,761 |
| Acquired on acquisition | — | 141 | — | 1,266 | 162 | 1,569 |
| Additions | 110 | 576 | 244 | 3,267 | 18 | 4,215 |
| Disposals | — | (159) | (1,093) | (11,902) | (77) | (13,231) |
| Disposal of subsidiary | — | (423) | (120) | (1,920) | — | (2,463) |
| At 1 January 2014 | 110 | 9,613 | 4,093 | 30,709 | 1,326 | 45,851 |
| Acquired on acquisition | 581 | 52 | — | 386 | 217 | 1,236 |
| Additions | — | 484 | 899 | 3,140 | 13 | 4,536 |
| Disposals | — | (142) | (1,703) | (708) | (195) | (2,748) |
| **At 31 December 2014** | **691** | **10,007** | **3,289** | **33,527** | **1,361** | **48,875** |
| **Depreciation** | | | | | | |
| At 1 January 2013 | — | 5,003 | 3,742 | 29,912 | 1,123 | 39,780 |
| Acquired on acquisition | — | 99 | — | 997 | 103 | 1,199 |
| Provided in the year | — | 1,209 | 509 | 3,156 | 50 | 4,924 |
| Eliminated on disposals | — | (116) | (1,095) | (11,744) | (55) | (13,010) |
| Disposal of subsidiary | — | (228) | (101) | (1,781) | — | (2,110) |
| At 1 January 2014 | — | 5,967 | 3,055 | 20,540 | 1,221 | 30,783 |
| Acquired on acquisition | — | 45 | — | 282 | 163 | 490 |
| Provided in the year | — | 917 | 355 | 3,033 | 57 | 4,362 |
| Eliminated on disposals | — | (143) | (1,603) | (708) | (186) | (2,640) |
| **At 31 December 2014** | **—** | **6,786** | **1,807** | **23,147** | **1,255** | **32,995** |
| **Carrying amount** | | | | | | |
| **At 31 December 2014** | **691** | **3,221** | **1,482** | **10,380** | **106** | **15,880** |
| At 31 December 2013 | 110 | 3,646 | 1,038 | 10,169 | 105 | 15,068 |

## 14. Investments

| | Joint ventures £'000 |
|---|---|
| At 1 January 2014 | — |
| Acquired on acquisition | 1,617 |
| Share of results of equity accounted joint ventures | 239 |
| **At 31 December 2014** | **1,856** |

The principal undertakings within the Group at 31 December 2014 are shown below:

| | Proportion held | Country of registration | Nature of business |
|---|---|---|---|
| Mears Limited | 100% | England and Wales | Provision of maintenance services |
| Scion Technical Services Limited | 100% | England and Wales | Provision of maintenance services |
| Scion Estates Limited | 100% | England and Wales | Provision of grounds maintenance |
| Jackson Lloyd Limited | 100% | England and Wales | Provision of maintenance services |
| Morrison Facilities Services Limited | 100% | Scotland | Provision of maintenance services |
| Mears Scotland LLP | 66.67% | Scotland | Provision of maintenance services |
| Manchester Working Limited | 80% | England and Wales | Provision of maintenance services |
| Mears Home Improvements Limited | 100% | England and Wales | Provision of maintenance services |
| Omega Lettings Limited | 100% | England and Wales | Provision of housing management services |
| Plexus UK (First Project) Limited | 100% | England and Wales | Provision of housing management services |
| Mears Care Limited | 100% | England and Wales | Provision of care |
| Mears Care (Northern Ireland) Limited | 100% | Northern Ireland | Provision of care |
| Mears Care (Scotland) Limited | 100% | Scotland | Provision of care |
| Independent Living Services (ILS) Limited | 100% | Scotland | Provision of care |
| Nurseplus Limited | 100% | Scotland | Provision of care |
| Terraquest Solutions Limited | 100% | England and Wales | Provision of professional services |
| Mears Insurance Company Limited | 99.99% | Guernsey | Provision of insurance services |

All material subsidiary undertakings with the exception of Manchester Working Limited prepare accounts to 31 December. Manchester Working Limited prepares accounts to 31 March in line with the minority shareholder.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 14. Investments continued

A full list of subsidiary undertakings is available from the Company Secretary upon request.

The table below sets out selected financial information in respect of subsidiaries that have non-controlling interests that are material to the Group:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Share of revenue and profits** | | |
| Revenue | **86,541** | 73,607 |
| Expenses and taxation | **(86,897)** | (74,753) |
| Loss for the year | **(356)** | (1,146) |
| Other comprehensive (expense)/income | **(5,181)** | 502 |
| Total comprehensive expense | **(5,537)** | (644) |
| Loss for the year allocated to non-controlling interests | **(51)** | (231) |
| Total comprehensive expense allocated to non-controlling interests | **(1,777)** | (231) |
| **Share of net assets** | | |
| Non-current assets | **400** | 14,846 |
| Current assets | **18,890** | 16,512 |
| Current liabilities | **(25,182)** | (31,713) |
| Total assets less total liabilities | **(5,892)** | (355) |
| Equity shareholders' funds | **(3,545)** | 215 |
| Non-controlling interests | **(2,347)** | (570) |
| Total equity | **(5,892)** | (355) |

The financial and operating activities of the Group's joint ventures are jointly controlled by the participating shareholders. The participating shareholders have rights to the net assets of the joint ventures through their equity shareholdings. The Group held investments in the following joint ventures at 31 December 2014:

| | Proportion held | Country of registration | Nature of business |
|---|---|---|---|
| Mears 24/7 LLP | 50% | England and Wales | Provision of call centre services |
| Asert LLP | 50% | England and Wales | Provision of customer service training |
| Tando Property Services Limited | 50% | England and Wales | Provision of housing management services |
| O&T Developments Limited | 50% | England and Wales | Provision of housing management services |

## 14. Investments continued

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Share of revenue and profits** | | |
| Revenue | **2,930** | — |
| Expenses and taxation | **(2,691)** | — |
| Profit for the year | **239** | — |
| **Share of net assets** | | |
| Non-current assets | **30** | — |
| Current assets | **2,613** | — |
| Current liabilities | **(787)** | — |
| | **1,856** | — |

The following UK subsidiaries will take advantage of the audit exemption set out within Section 479A of the Companies Act 2006 for the year ending 31 December 2014 (31 March 2015 in the case of Zenon Property Services Limited):

| | Registration number |
|---|---|
| Heather Housing Limited | 07713632 |
| Let to Birmingham Limited | 08757503 |
| Scion Group Limited | 03905442 |
| Scion Technical Services Limited | 03671450 |
| Scion Estates Limited | 03720903 |
| Zenon Property Services Limited | 07448134 |

## 15. Inventories

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Materials and consumables | **5,065** | 3,773 |
| Work in progress | **3,403** | 6,679 |
| | **8,468** | 10,452 |

The Group consumed inventories totalling £613.7m during the year (2013: £641.1m). No items are being carried at fair value less costs to sell (2013: £nil).

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 16. Trade and other receivables

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Current assets: | | |
| – trade receivables | **44,023** | 44,322 |
| – amounts recoverable on non-construction contracts | **90,154** | 95,046 |
| – prepayments and accrued income | **8,439** | 11,914 |
| – current tax assets | **—** | 411 |
| Total trade and other receivables | **142,616** | 151,693 |

Trade receivables are normally due within 30 to 60 days and do not bear any effective interest rate. All trade receivables and accrued income are subject to credit risk exposure. Social Housing customers are typically Local Authorities and Housing Associations where credit risk is minimal. Care customers are typically County Councils where credit risk is minimal.

The ageing analysis of trade receivables is as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Neither impaired nor past due | **38,852** | 39,501 |
| Less than three months past due but not impaired | **2,844** | 2,906 |
| More than three months past due but not impaired | **2,327** | 1,915 |
| Total trade and other receivables | **44,023** | 44,322 |

## 17. Trade and other payables

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Trade payables | **103,943** | 100,692 |
| Accruals and deferred income | **43,494** | 69,708 |
| Social security and other taxes | **22,291** | 21,804 |
| Payments on account for non-construction contract work | **5,435** | 923 |
| Finance lease liabilities | **514** | — |
| Other creditors | **6,421** | 3,848 |
| | **182,098** | 196,975 |

The fair value of trade payables has not been disclosed as, due to their short duration, management considers the carrying amounts recognised in the Balance Sheet to be a reasonable approximation of their fair value.

Included in other creditors is £0.3m (2013: £0.6m) relating to contingent consideration on acquisitions.

## 18. Financing liabilities

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Current liabilities: | | |
| – interest rate swaps | **580** | 478 |
| Non-current liabilities: | | |
| – interest rate swaps | **788** | 701 |
| Total financing liabilities | **1,368** | 1,179 |

## 19. Long-term other liabilities

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Other creditors | **25,956** | 1,278 |

Included in other creditors is £20.7m (2013: £1.3m) relating to contingent consideration on acquisitions.

## 20. Financial instruments

The Group uses a limited number of financial instruments comprising cash and liquid resources, borrowings, interest rate swaps and various items such as trade receivables and trade payables that arise directly from its operations. The main purpose of these financial instruments is to finance the Group's operations. The Group seeks to finance its operations through a combination of retained earnings and borrowings and investing surplus cash on deposit. The Group uses financial instruments to manage the interest rate risks arising from its operations and sources of finance but has no interests in the trade of financial instruments.

**Categories of financial instruments**

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Financial assets** | | |
| **Loans and receivables** | | |
| Trade receivables | **44,023** | 44,322 |
| Amounts recoverable on contracts | **90,154** | 95,046 |
| Cash at bank and in hand | **66,634** | 79,552 |
| | **200,811** | 218,920 |
| **Financial liabilities** | | |
| **Fair value (level 2)** | | |
| Interest rate swaps – effective | **—** | (1,179) |
| Interest rate swaps – ineffective | **(1,368)** | — |
| **Fair value (level 3)** | | |
| Deferred and contingent consideration in respect of acquisitions | **(21,045)** | (1,836) |
| **Amortised cost** | | |
| Bank borrowings and overdrafts | **(62,800)** | (80,000) |
| Trade payables | **(103,943)** | (100,692) |
| Accruals and deferred income | **(43,494)** | (69,708) |
| Other creditors | **(11,332)** | (3,848) |
| | **(243,982)** | (257,263) |
| | **(43,171)** | (38,343) |

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 20. Financial instruments continued

### Categories of financial instruments continued

The IFRS 7 hierarchy level categorisation relates to the extent the fair value can be determined by reference to comparable market values. The classifications range from level 1, where instruments are quoted on an active market, through to level 3, where the assumptions used to arrive at fair value do not have comparable market data.

The fair values of interest rate swaps have been calculated by a third party expert discounting estimated future cash flows on the basis of market expectations of future interest rates (level 2).

The fair values of contingent consideration has been calculated by the Directors by reference to expected future income and expenditure in respect of the acquired businesses.

There have been no transfers between levels during the year.

### Fair value information

The fair value of the Group's financial assets and liabilities is as disclosed above and approximates to the book value.

### Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including interest rate risk and price risk); credit risk; and liquidity risk. The main risks faced by the Group relate to the availability of funds to meet business needs and the risk of credit default by customers. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

Risk management is carried out under policies and guidelines approved by the Board of Directors.

### Borrowing facilities

The Group's borrowing facilities are drawn on as required to manage its cash needs. Banking facilities are reviewed regularly and extended and replaced in advance of their expiry.

The Group had total borrowing facilities of £120.0m with Barclays Bank PLC and HSBC plc, of which £62.5m was utilised at 31 December 2014.

The facilities comprise a committed five-year £110.0m revolving credit facility and an unsecured overdraft facility of £10.0m. The undrawn amounts at 31 December 2014 were a £47.5m revolving credit facility and an overdraft facility of £10.0m.

### Interest rate risk management

The Group finances its operations through a mixture of retained profits and bank borrowings from major banking institutions at floating rates of interest based on LIBOR. The Group's exposure to interest rate fluctuations on borrowings is managed through the use of interest rate swaps; hence the fixed rate borrowings relate to floating rate loans where the interest rate has been fixed by a hedging arrangement. The fair value of interest rate exposure on financial liabilities of the Group as at 31 December 2014 was:

| | Interest rate | | | |
|---|---|---|---|---|
| | Fixed £'000 | Floating £'000 | Zero £'000 | Total £'000 |
| **Financial liabilities – 2014** | **57,500** | **5,300** | **21,045** | **83,845** |
| Financial liabilities – 2013 | 55,000 | 25,000 | 1,836 | 81,836 |

The Group's policy is to accept a degree of interest rate risk, provided the effects of the various potential changes in rates remain within certain prescribed parameters.

Accordingly, the Group has hedged the first £57.5m of the £120m revolving credit facility by entering into interest rate swap arrangements with Barclays Bank PLC and HSBC plc. This consists of one £27.5m swap contract expiring in August 2016 and one £30.0m swap contract expiring in August 2018, both with quarterly maturity, matching the underlying facility.

## 20. Financial instruments continued

### Interest rate risk management continued

The maturity of the interest rate swap contracts is as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Nominal amount hedged £'000 | Average applicable interest rates % | Nominal amount hedged £'000 | Average applicable interest rates % |
| Within one year | — | — | — | — |
| One to two years | — | — | — | — |
| Two to five years | 57,500 | 1.88% | 55,000 | 1.95% |
| More than five years | — | — | — | — |

### Effective interest rates

Interest rate swaps with fair value liabilities of £1.4m (2013: £1.2m) and average remaining lives of two years and nine months have been accounted for in financing liabilities.

The Group's overall average cost of debt, including effective and ineffective interest rate swaps, is 3.2% as at 31 December 2014 (2013: 3.1%). Excluding these swaps the average is 2.2% (2013: 2.2%).

### Cash flow hedging reserve

The cash flow hedging reserve comprises all gains and losses arising from the valuation of interest swap contracts which are effective hedges and mature after the year end. These are valued on a mark-to-market basis, are accounted for through the Statement of Comprehensive Income and are recycled through the Consolidated Income Statement when the hedged item affects the Consolidated Income Statement.

During the year, the Group restructured one of its interest rate swaps. No cash consideration was paid or received on settling the old interest rate swap or transacting the new interest rate swap. As a result of the restructure, the interest rate swaps become ineffective for the purposes of IAS 39, though the Group still considered the swaps to be economically effective. Amounts that had been recognised in other comprehensive income are being recycled on a straight-line basis from equity to the Consolidated Income Statement over the period in which the hedged forecast cash flows affect profit or loss.

The interest rate swap contracts have quarterly maturity and expire in August 2016 and August 2018.

Movements during the year were:

| | £'000 |
|---|---|
| At 1 January 2013 | (1,913) |
| Amounts transferred to the Consolidated Income Statement | 791 |
| Revaluations during the year | 593 |
| Deferred tax movement | (319) |
| At 1 January 2014 | (848) |
| Amounts transferred to the Consolidated Income Statement | 722 |
| Revaluations during the year | (841) |
| Deferred tax movement | 5 |
| **At 31 December 2014** | **(962)** |

At 31 December 2014 the Group had minimal exposure to movement in interest rates as the remaining interest rate risk was offset by the Group's cash and short-term deposits.

If the interest rates had been 0.5% higher or lower and all other variables were held constant, the Group's profit before taxation for the year ended 31 December 2014 and reserves would decrease or increase, respectively, by £0.1m.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 20. Financial instruments continued

### Liquidity risk management

The Group seeks to manage liquidity risk by ensuring sufficient liquidity is available to meet foreseeable needs and to invest cash assets safely and profitably.

Management monitors rolling forecasts of the Group's liquidity reserve (comprising undrawn borrowing facilities and cash and cash equivalents) on the basis of expected cash flows. This is generally carried out at a local level in the operating companies of the Group in accordance with practice and limits set by the Group. These limits vary by location and take into account the liquidity and nature of the market in which the entity operates.

The quantum of committed borrowing facilities of the Group is regularly reviewed and is designed to exceed forecasted peak gross debt levels. For short-term working capital purposes, the Group utilises bank overdrafts as required. These facilities are regularly reviewed and are renegotiated ahead of their expiry date.

The table below shows the maturity profile of the Group's financial liabilities:

| | Within 1 year £'000 | 1–2 years £'000 | 2–5 years £'000 | Over 5 years £'000 | Total £'000 |
|---|---|---|---|---|---|
| **2014** | | | | | |
| **Non-derivative financial liabilities:** | | | | | |
| Bank borrowings | **5,300** | **—** | **57,500** | **—** | **62,800** |
| Trade and other payables | **153,538** | **5,231** | **—** | **—** | **158,769** |
| Deferred and contingent consideration in respect of acquisitions | **320** | **20,725** | **—** | **—** | **21,045** |
| **Derivative financial liabilities:** | | | | | |
| Interest rate swaps – ineffective | **580** | **428** | **360** | **—** | **1,368** |
| **2013** | | | | | |
| **Non-derivative financial liabilities:** | | | | | |
| Bank borrowings | 25,000 | — | 55,000 | — | 80,000 |
| Trade and other payables | 173,690 | — | — | — | 173,690 |
| Deferred and contingent consideration in respect of acquisitions | 558 | 1,278 | — | — | 1,836 |
| **Derivative financial liabilities:** | | | | | |
| Interest rate swaps – effective | 478 | 401 | 300 | — | 1,179 |

The Group has disclosed core bank borrowings of £57.5m as due in two to five years. Whilst the amounts borrowed could be repaid each quarter, the Group's intention is to align core bank borrowings with its interest rate swaps.

## 20. Financial instruments continued

### Credit risk management

The Group's credit risk is primarily attributable to its trade receivables, amounts recoverable on contracts and work in progress. The amounts presented in the Balance Sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and the current economic environment.

Trade receivables are normally due within 30 to 60 days. Trade and other receivables included in the Balance Sheet are stated net of a bad debt provision which has been estimated by management following a review of individual receivable accounts. There is no Group-wide rate of provision and provision made for debts that are overdue is based on prior default experience and known factors at the balance sheet date. Receivables are written off against the bad debt provision when management considers that the debt is no longer recoverable.

Social Housing customers are typically Local Authorities and Housing Associations. Care customers are typically County Councils. The nature of both of these customers means that credit risk is minimal. Other trade receivables contain no specific concentration of credit risk as the amounts recognised represent a large number of receivables from various customers.

The Group continually monitors the position of major customers and incorporates this information into its credit risk controls. External credit ratings are obtained where appropriate.

Details of the ageing of trade receivables are shown in note 16.

### Deferred and contingent consideration

The table below shows the movements in deferred and contingent consideration:

| | Total £'000 |
|---|---|
| At 1 January 2013 | 1,501 |
| Increase due to new acquisitions in the year | 500 |
| Paid in respect of acquisitions | (204) |
| Unwinding of discounting | 39 |
| At 1 January 2014 | 1,836 |
| Increase due to new acquisitions in the year | 20,000 |
| Paid in respect of acquisitions | (387) |
| Released on re-assessment | (424) |
| Unwinding of discounting | 20 |
| **At 31 December 2014** | **21,045** |

Contingent consideration represents an estimate of future consideration likely to be payable in respect of acquisitions. Contingent consideration is discounted for the likelihood of payment and for the time value of money. Contingent consideration becomes payable based upon the profitability of acquired businesses or, in the case of one specific acquisition, the utilisation of certain timing differences in respect of corporation tax. The fair value of contingent consideration is estimated by forecasting future profits and utilising the forecast to determine the likely contingent consideration payable.

Information as to the likely timing of payments in respect of these provisions financial liabilities is provided earlier within this note.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 20. Financial instruments continued

### Capital management

The Group's objectives when managing capital are:

- to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- to provide an adequate return to shareholders by pricing products and services commensurately with the level of risk; and
- to maintain an optimal capital structure to reduce the cost of capital.

The Group sets the amount of capital in proportion to risk. The Group manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The capital structure of the Group consists of net debt as disclosed below and equity as disclosed in the Consolidated Statement of Changes in Equity.

| | **2014 £'000** | 2013 £'000 |
|---|---|---|
| Cash and cash equivalents is comprised as follows: | | |
| – cash at bank and in hand | **66,634** | 79,552 |
| – bank borrowings and overdrafts | **(62,800)** | (80,000) |
| Cash and cash equivalents | **3,834** | (448) |

## 21. Deferred taxation

Deferred tax is calculated on temporary differences under the liability method.

### Deferred tax asset

The following deferred tax assets were recognised by the Group as at 31 December 2014:

| | Pension scheme £'000 | Share-based payments £'000 | Cash flow hedges £'000 | Tax losses £'000 | Short-term temporary differences £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| At 1 January 2013 | 1,321 | 2,801 | 571 | 7,134 | 3,601 | 15,428 |
| Acquired on acquisition | — | — | — | — | 209 | 209 |
| Debit to Consolidated Income Statement | (188) | (594) | — | (3,276) | (241) | (4,299) |
| Debit to Consolidated Statement of Changes in Equity | — | (599) | — | — | — | (599) |
| Credit/(debit) to Consolidated Statement of Comprehensive Income | 150 | — | (319) | — | — | (169) |
| At 1 January 2014 | 1,283 | 1,608 | 252 | 3,858 | 3,569 | 10,570 |
| Acquired on acquisition | — | — | — | — | (4) | (4) |
| (Credit)/debit to Consolidated Income Statement | (252) | 121 | — | 500 | (2,593) | (2,224) |
| Credit to Consolidated Statement of Changes in Equity | — | (418) | — | — | — | (418) |
| Credit to Consolidated Statement of Comprehensive Income | 644 | — | 5 | — | — | 649 |
| **At 31 December 2014** | **1,675** | **1,311** | **257** | **4,358** | **972** | **8,573** |

In accordance with IFRS 2 'Share-based Payments', the Group has recognised an expense for the consumption of employee services received as consideration for share options granted. A tax deduction will not arise until the options are exercised. The tax deduction in future periods is dependent upon the Company's share price at the date of exercise. The estimated future tax deduction is based on the options' intrinsic value at the balance sheet date.

The cumulative amount credited to the Consolidated Income Statement is limited to the tax effect of the associated cumulative share-based payment expense. The excess has been credited directly to equity. This is presented in the Consolidated Statement of Comprehensive Income.

In addition to those recognised above, unused tax losses totalling £28.9m (2013: £25.5m) have not been recognised as the Directors do not consider that it is probable that they will be recovered.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 21. Deferred taxation continued

The following deferred tax liabilities were recognised by the Group as at 31 December 2014:

**Deferred tax liabilities**

| | Pension scheme £'000 | Acquisition intangibles £'000 | Total £'000 |
|---|---|---|---|
| At 1 January 2013 | 3,225 | 8,263 | 11,488 |
| Acquired on acquisition | — | 1,582 | 1,582 |
| Charge/(credit) to Consolidated Income Statement | 295 | (3,174) | (2,879) |
| Credit to Consolidated Statement of Comprehensive Income | (427) | — | (427) |
| At 1 January 2014 | 3,093 | 6,671 | 9,764 |
| Acquired on acquisition | — | 2,173 | 2,173 |
| Credit to Consolidated Income Statement | (17) | (2,452) | (2,469) |
| Credit to Consolidated Statement of Comprehensive Income | (50) | — | (50) |
| **At 31 December 2014** | **3,026** | **6,392** | **9,418** |

Intangible assets acquired as part of a business combination are capitalised at fair value at the date of the acquisition and amortised over their useful economic lives. The UK tax regime calculates tax using the individual financial statements of the members of the Group and not the consolidated accounts. Hence, the tax base of acquisition intangible assets is £nil. The estimated tax effect of this £nil tax base is accounted for as a deferred tax liability which is released over the period of amortisation of the associated acquisition intangible asset.

## 22. Share capital and reserves

**Classes of reserves**

Share capital represents the nominal value of shares that have been issued.

Share premium represents the difference between the nominal value of shares issued and the total consideration received.

Share-based payment reserve represents employee remuneration which is credited to the share-based payment reserve until the related share options are exercised. Upon exercise the share-based payment reserve is transferred to retained earnings.

The cash flow hedging reserve comprises all gains and losses arising from the valuation of interest swap contracts which are effective hedges and mature after the year end. These are valued on a mark-to-market basis, are accounted for through the Statement of Comprehensive Income and are recycled through the Consolidated Income Statement when the hedged item affects the Consolidated Income Statement.

The merger reserve relates to the difference between the nominal value and total consideration in respect of acquisitions, where the Company was entitled to the merger relief offered by the Companies Act.

## 22. Share capital and reserves continued

### Share capital

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Allotted, called up and fully paid** | | |
| At 1 January 100,661,649 (2013: 91,859,911) ordinary shares of 1p each | **1,007** | 919 |
| Issue of nil (2013: 6,368,069) shares as a share placement | **—** | 64 |
| Issue of 472,493 (2013: 2,433,670) shares on exercise of share options | **4** | 24 |
| At 31 December 101,134,142 (2013: 100,661,649) ordinary shares of 1p each | **1,011** | 1,007 |

During the year 472,493 (2013: 2,433,670) ordinary 1p shares were issued in respect of share options exercised. The difference between the nominal value of £0.004m and the total consideration of £0.6m has been credited to the share premium account.

## 23. Notes to the Consolidated Cash Flow Statement

The following non-operating cash flow adjustments have been made to the result for the year before tax:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Depreciation | **4,362** | 4,748 |
| Loss on disposal of property, plant and equipment | **3** | 215 |
| Amortisation | **13,480** | 11,904 |
| Share-based payments | **670** | 665 |
| IAS 19 pension movement | **(1,425)** | (2,538) |
| Finance income | **(77)** | (2) |
| Finance cost | **3,178** | 3,566 |
| Total | **20,191** | 18,558 |

## 24. Acquisitions

On 2 May 2014 the Group acquired the trade and assets of Careline CC for total consideration of £0.4m which was satisfied in cash. On 15 May 2014 the Group acquired the entire share capital of InSitu Care Limited for total consideration of £0.3m which was satisfied in cash. On 7 July 2014 the Group acquired the trade and assets of AginCare for total consideration of £0.2m which was satisfied in cash. These three acquisitions were completed to grow the Group's workforce within Wiltshire. On 20 August 2014 the Group acquired the entire issued share capital of Heatherpark Community Services Limited and Coulter Estates Limited for a total consideration of £1.8m which was satisfied in cash. This acquisition was completed to expand the Group's Care offering within Scotland. The effect of these four acquisitions on the Group's assets is detailed overleaf on a combined basis.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 24. Acquisitions continued

On 15 October 2014 the Group acquired the entire issued share capital of Omega Group for an initial consideration of £21.8m and a maximum contingent consideration of £20.0m. The contingent consideration is dependent on future profitability and is payable over a period of up to three years. The Directors' best estimate of contingent consideration payable is the full £20.0m. The acquisition of Omega provides a logical extension of the Group's current Housing offering; it will enhance the Group's ability to work with housing providers to improve the delivery of housing and property management. The effect of this acquisition on the Group's assets is detailed below.

| | Book and provisional fair value | | |
|---|---|---|---|
| | Omega Group £'000 | Other £'000 | Total £'000 |
| **Assets** | | | |
| **Non-current** | | | |
| Property, plant and equipment | 706 | 40 | 746 |
| Share of net assets of joint venture | 1,617 | — | 1,617 |
| Current | | | |
| Inventories | 211 | — | 211 |
| Trade receivables | 2,855 | 282 | 3,137 |
| Other receivables | 134 | 31 | 165 |
| Current tax asset | 137 | — | 137 |
| Cash at bank and in hand | 2,382 | 37 | 2,419 |
| **Total assets** | 8,042 | 390 | 8,432 |
| **Liabilities** | | | |
| **Current** | | | |
| Trade and other payables | 5,736 | 1,018 | 6,754 |
| Current tax liabilities | — | 154 | 154 |
| Deferred tax liabilities | — | 4 | 4 |
| **Total liabilities** | 5,736 | 1,176 | 6,912 |
| Net assets/(liabilities) acquired | 2,306 | (786) | 1,520 |
| Intangibles capitalised | 8,228 | 3,497 | 11,725 |
| Deferred tax liability recognised in respect of intangibles capitalised | (1,645) | (527) | (2,172) |
| Net assets acquired | 8,889 | 2,184 | 11,073 |
| Goodwill capitalised | 32,911 | 527 | 33,438 |
| | 41,800 | 2,711 | 44,511 |
| Satisfied by: | | | |
| – cash | 21,800 | 2,711 | 24,511 |
| – contingent consideration | 20,000 | — | 20,000 |
| | 41,800 | 2,711 | 44,511 |

## 24. Acquisitions continued

The Omega Group intangible asset is recognised and valued at £8.2m. This represents the expected value to be derived from the acquired customer relationships. The value placed on these customer relationships is based on the expected cash inflows over the estimated remaining life or each contract. The cash flows are discounted using a rate of 13.5% which the Directors consider is commensurate with the risks associated with capturing returns from the customer relationships. The estimated life for customer relationships is twelve years.

The Directors consider that the value assigned to goodwill represents the benefits to the Group of improvements in the delivery of housing and property management and the benefits from integration of the business models.

The intangible asset in respect of other acquisitions is recognised and valued at £3.5m. This represents the expected value to be derived from the acquired customer related contracts.

The amounts receivable detailed above are not materially different from the gross contractual amounts receivable. The effect of these acquisitions on the Group's assets and liabilities is disclosed as provisional due to the proximity of the acquisitions to the balance sheet date.

In the period ended 31 December 2014, the other acquisitions contributed revenue of £1.1m and a £0.2m operating profit before amortisation of acquisition intangibles.

For the year ended 31 December 2014, had the acquisitions taken place on 1 January 2014, the combined Group full-year revenue for the year is estimated at £855.6m and the combined Group profit for the year before taxation is estimated at £31.9m.

Analysis of net outflow in respect of the purchase of the subsidiary undertakings:

| | Total £'000 |
|---|---|
| Cash consideration | (24,511) |
| Cash at bank and in hand acquired | 2,419 |
| Cash payments in respect of prior year acquisitions | (129) |
| | 22,221 |

## 25. Pensions

### Defined contribution schemes

The Group operates a defined contribution Group personal pension scheme for the benefit of certain employees. The Group contributes to personal pension schemes of certain Directors and senior employees. The Group operates a stakeholder pension plan available to all employees. During the year, the Group contributed £4.0m (2013: £3.1m) to these schemes.

### IAS 19 'Employee Benefits'

The Group contributes to 30 (2013: 32) principal defined benefit schemes on behalf of a number of employees which require contributions to be made to separately administered funds.

These pension schemes are operated on behalf of Mears Limited, Mears Care Limited, Morrison Facilities Services Limited and their subsidiary undertakings. The assets of the schemes are administered by trustees in funds independent from the assets of the Group.

In certain cases, the Group will participate under Admitted Body status in the Local Government pension scheme. The Group will contribute for a finite period up until the end of the particular contract. The Group is required to pay regular contributions as detailed in the scheme's schedule of contributions. In some cases these contributions are capped and any excess can be recovered from the body from which the employees originally transferred. Where the Group has a contractual right to recover the costs of making good any deficit in the scheme from the Group's client, the fair value of that asset has been recognised within the Group's share of the scheme assets and disclosed on page 116. Certain judgements around the value of this asset have been made and are discussed in the judgements and estimates disclosure within the accounting policies.

The disclosures in respect of the two (2013: two) Group defined benefit schemes and the 28 (2013: 30) other defined benefit schemes in this note have been aggregated.

Costs and liabilities of the schemes are based on actuarial valuations. The latest full actuarial valuations for the schemes were updated to 31 December 2014 by qualified independent actuaries using the projected unit method.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 25. Pensions continued

### IAS 19 'Employee Benefits' continued

The principal actuarial assumptions at the balance sheet date are as follows:

| | 2014 | 2013 |
|---|---|---|
| Rate of increase of salaries – first year | **1.00%** | 1.00% |
| Rate of increase of salaries – second year | **2.20%** | 1.00% |
| Rate of increase of salaries – long term | **3.25%** | 3.35% |
| Rate of increase for pensions in payment – based on CPI with a cap of 5% | **2.35%** | 2.45% |
| Rate of increase for pensions in payment – based on RPI with a cap of 5% | **3.15%** | 3.25% |
| Rate of increase for pensions in payment – based on CPI with a cap of 3% | **2.05%** | 2.10% |
| Rate of increase for pensions in payment – based on RPI with a cap of 3% | **2.50%** | 2.55% |
| Discount rate | **4.00%** | 4.60% |
| Retail Prices inflation | **3.25%** | 3.35% |
| Consumer Prices inflation | **2.35%** | 2.45% |
| Life expectancy for a 65 year old male | **22.2 years** | 21.7 years |
| Life expectancy for a 65 year old female | **24.5 years** | 24.1 years |

The amounts recognised in the Consolidated Balance Sheet and major categories of plan assets are:

| | **2014** | | | 2013 | | |
|---|---|---|---|---|---|---|
| | **Group schemes £'000** | **Other schemes £'000** | **Total £'000** | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Equities – quoted | **40,426** | **179,433** | **219,859** | 50,449 | 173,857 | 224,306 |
| Equities – unquoted | **—** | **28,696** | **28,696** | — | 27,804 | 27,804 |
| Bonds – quoted | **60,961** | **66,875** | **127,836** | 44,800 | 63,449 | 108,249 |
| Bonds – unquoted | **—** | **5,046** | **5,046** | — | 4,787 | 4,787 |
| Guarantee | **—** | **17,740** | **17,740** | — | 785 | 785 |
| Property – quoted | **—** | **3,522** | **3,522** | — | 3,252 | 3,252 |
| Property – unquoted | **408** | **17,570** | **17,978** | 347 | 16,226 | 16,573 |
| Cash | **14,023** | **28,152** | **42,175** | 3,314 | 34,563 | 37,877 |
| Group's estimated asset share | **115,818** | **347,034** | **462,852** | 98,910 | 324,723 | 423,633 |
| Present value of funded scheme liabilities | **(106,710)** | **(331,666)** | **(438,376)** | (88,195) | (295,641) | (383,836) |
| Funded status | **9,108** | **15,368** | **24,476** | 10,715 | 29,082 | 39,797 |
| Scheme surpluses not recognised as assets | **—** | **(17,717)** | **(17,717)** | — | (31,173) | (31,173) |
| Pension asset/(liability) | **9,108** | **(2,349)** | **6,759** | 10,715 | (2,091) | 8,624 |

## 25. Pensions continued

### IAS 19 'Employee Benefits' continued

The amounts recognised in the Income Statement are as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Current service cost | 2,009 | 6,785 | 8,794 | 2,021 | 5,860 | 7,881 |
| Past service cost | — | 101 | 101 | — | 393 | 393 |
| Administration costs | 224 | 109 | 333 | 568 | 150 | 718 |
| Curtailment | — | — | — | — | 15 | 15 |
| Total operating charge | 2,233 | 6,995 | 9,228 | 2,589 | 6,418 | 9,007 |
| Net interest | (561) | (1,249) | (1,810) | (565) | (1,151) | (1,716) |
| Total charged to the result for year | 1,672 | 5,746 | 7,418 | 2,024 | 5,267 | 7,291 |

Cumulative actuarial gains and losses recognised in equity are as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| On TUPE transfer of employees | — | 121 | 121 | — | (136) | (136) |
| Return on plan assets below that recorded in net interest | 10,624 | 22,125 | 32,749 | 3,796 | 25,804 | 29,600 |
| Actuarial gain/(loss) arising from changes in demographic assumptions | — | 2,283 | 2,283 | 1,040 | (611) | 429 |
| Actuarial loss arising from changes in financial assumptions | (14,832) | (47,805) | (62,637) | (6,879) | (23,770) | (30,649) |
| Actuarial gain arising from liability experience | 910 | 9,828 | 10,738 | 932 | 518 | 1,450 |
| Effects of limitation of recognisable surplus | — | 13,456 | 13,456 | — | (2,890) | (2,890) |
| Total gains and losses recognised in equity | (3,298) | 8 | (3,290) | (1,111) | (1,085) | (2,196) |
| At 1 January | (2,138) | (7,541) | (9,679) | (1,027) | (6,456) | (7,483) |
| Total at 31 December | (5,436) | (7,533) | (12,969) | (2,138) | (7,541) | (9,679) |

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 25. Pensions continued

**IAS 19 'Employee Benefits'** continued

Changes in the present value of the defined benefit obligations are as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Present value of obligations at 1 January | 88,195 | 295,641 | 383,836 | 79,336 | 260,868 | 340,204 |
| Current service cost | 2,009 | 6,785 | 8,794 | 2,021 | 5,860 | 7,881 |
| Past service cost | — | 101 | 101 | — | 393 | 393 |
| Scheme administration costs | — | 46 | 46 | — | 71 | 71 |
| Interest on obligations | 4,028 | 13,408 | 17,436 | 3,682 | 12,096 | 15,778 |
| Plan participants' contributions | 453 | 2,134 | 2,587 | 524 | 2,189 | 2,713 |
| Benefits paid | (1,897) | (6,061) | (7,958) | (2,275) | (6,069) | (8,344) |
| Contract transfer | — | (16,082) | (16,082) | — | (3,645) | (3,645) |
| Curtailments | — | — | — | — | 15 | 15 |
| Actuarial (gain)/loss arising from changes in demographic assumptions | — | (2,283) | (2,283) | (1,040) | 611 | (429) |
| Actuarial loss arising from changes in financial assumptions | 14,832 | 47,805 | 62,637 | 6,879 | 23,770 | 30,649 |
| Actuarial gain arising from liability experience | (910) | (9,828) | (10,738) | (932) | (518) | (1,450) |
| Present value of obligations at 31 December | 106,710 | 331,666 | 438,376 | 88,195 | 295,641 | 383,836 |

Changes in the fair value of the plan assets are as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Fair value of plan assets at 1 January | 98,910 | 324,723 | 423,633 | 89,737 | 287,032 | 376,769 |
| Expected return on plan assets | 4,589 | 14,657 | 19,246 | 4,247 | 13,247 | 17,494 |
| Employers' contributions | 3,363 | 5,480 | 8,843 | 3,449 | 6,380 | 9,829 |
| Plan participants' contributions | 453 | 2,134 | 2,587 | 524 | 2,189 | 2,713 |
| Benefits paid | (1,897) | (6,061) | (7,958) | (2,275) | (6,069) | (8,344) |
| Scheme administration costs | (224) | (63) | (287) | (568) | (79) | (647) |
| Contract transfer | — | (15,961) | (15,961) | — | (3,781) | (3,781) |
| Return on plan assets above that recorded in net interest | 10,624 | 22,125 | 32,749 | 3,796 | 25,804 | 29,600 |
| Fair value of plan assets at 31 December | 115,818 | 347,034 | 462,852 | 98,910 | 324,723 | 423,633 |

## 25. Pensions continued

**IAS 19 'Employee Benefits'** continued

History of experience gains and losses are as follows:

| | Group schemes | | | | |
|---|---|---|---|---|---|
| | **2014 £'000** | 2013 £'000 | 2012 £'000 | 2011 £'000 | 2010 £'000 |
| Fair value of scheme assets | **115,818** | 98,910 | 89,737 | 8,305 | 7,694 |
| Net present value of defined benefit obligations | **(106,710)** | (88,195) | (79,336) | (13,097) | (13,112) |
| Net surplus/(deficit) | **9,108** | 10,715 | 10,401 | (4,792) | (5,418) |
| **Experience adjustments arising on scheme assets** | | | | | |
| Amount | **10,624** | 3,796 | 695 | (711) | (20) |
| Percentage of scheme assets | **9.2%** | 3.8% | 0.8% | (8.6%) | (0.3%) |
| **Experience adjustments arising on scheme liabilities** | | | | | |
| Amount | **(910)** | (932) | — | (21) | (21) |
| Percentage of scheme liabilities | **(0.9%)** | (1.1%) | — | (0.2%) | (0.2%) |

| | Other schemes | | | | |
|---|---|---|---|---|---|
| | **2014 £'000** | 2013 £'000 | 2012 £'000 | 2011 £'000 | 2010 £'000 |
| Fair value of scheme assets | **347,034** | 324,723 | 286,328 | 74,310 | 75,995 |
| Net present value of defined benefit obligations | **(331,666)** | (295,641) | (260,689) | (68,828) | (77,725) |
| Net surplus/(deficit) | **15,368** | 29,082 | 25,639 | 5,482 | (1,730) |
| Asset value not recognised as surplus | **(17,717)** | (31,172) | (27,758) | (6,530) | (545) |
| Net deficit | **(2,349)** | (2,091) | (2,119) | (1,048) | (2,275) |
| **Experience adjustments arising on scheme assets** | | | | | |
| Amount | **22,125** | 25,805 | 3,991 | (11,759) | 3,521 |
| Percentage of scheme assets | **6.4%** | 7.9% | 1.4% | (15.8%) | 4.6% |
| **Experience adjustments arising on scheme liabilities** | | | | | |
| Amount | **(9,828)** | (518) | 143 | 8,521 | 397 |
| Percentage of scheme liabilities | **(3.0%)** | (0.2%) | 0.1% | 12.4% | 0.5% |

Funding arrangements are agreed for each of the Group's defined benefit pension schemes with their respective trustees. The employers' contributions expected to be paid during the financial year ending 31 December 2015 amount to £8.3m.

Each of the schemes manage risks through a variety of methods and strategies to limit downside in falls in equity markets, movement in inflation and movements in interest rates.

# Notes to the financial statements – Group continued

For the year ended 31 December 2014

## 25. Pensions continued

**IAS 19 'Employee Benefits'** continued

The Group's defined benefit obligation is sensitive to changes in certain key assumptions. The sensitivity analysis below shows how a reasonably possible increase or decrease in a particular assumption, in isolation, results in an increase or decrease in the present value of the defined benefit obligation as at 31 December 2014.

| | **Decrease by 0.1% £'000** | Increase by 0.1% £'000 |
|---|---|---|
| Rate of inflation | **(1,500)** | 1,080 |
| Rate of increase in salaries | **(495)** | 500 |
| Discount rate | **2,778** | (2,649) |
| Life expectancy | **(6,245)** | 4,362 |

The sensitivity analysis may not be representative of an actual change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation of each other. In presenting this sensitivity analysis, the value of the defined benefit obligation has been calculated on the same basis that applied in calculating the defined benefit obligation recognised at the balance sheet date.

## 26. Operating lease commitments

Non-cancellable operating lease rentals payable were as follows:

| | Land and buildings | | Other | |
|---|---|---|---|---|
| | **2014 £'000** | 2013 £'000 | **2014 £'000** | 2013 £'000 |
| **Payable** | | | | |
| Within one year | **2,554** | 2,512 | **13,447** | 15,010 |
| Between two and five years | **5,403** | 5,398 | **11,875** | 15,768 |
| After more than five years | **2,365** | 1,964 | **—** | — |

Operating lease payments represent rentals payable by the Group for certain of its office properties, the hire of vehicles and the hire of other equipment. These leases have durations ranging from three to 15 years. No arrangements have been entered into in respect of contingent rental payments.

## 27. Capital commitments

The Group had no capital commitments at 31 December 2014 or at 31 December 2013.

## 28. Contingent liabilities

The Group has guaranteed that it will complete certain contracts that it has commenced. At 31 December 2014 these guarantees amounted to £26.3m (2013: £20.4m).

The Group had no other contingent liabilities at 31 December 2014 or at 31 December 2013.

## 29. Related party transactions

### Identity of related parties

The Group has a related party relationship with its pension schemes, its subsidiaries and with its Directors.

### Pension schemes

Details of contributions to pension schemes are set out in note 25 to the financial statements.

### Subsidiaries

The Group has a central treasury arrangement in which all subsidiaries participate. The Directors do not consider it meaningful to set out details of transfers made in respect of this treasury arrangement between companies, nor do they consider it meaningful to set out details of interest or dividend payments made within the Group.

### Transactions with key management personnel

The Group has identified key management personnel as the Directors of Mears Group PLC.

Key management personnel held the following percentage of voting shares in Mears Group PLC:

| | **2014 %** | 2013 % |
|---|---|---|
| Directors | **0.4** | 0.4 |

Key management personnel's compensation is as follows:

| | **2014 £'000** | 2013 £'000 |
|---|---|---|
| Salaries including social security costs | **1,561** | 2,966 |
| Contributions to defined contribution pension schemes | **185** | 185 |
| Share-based payments | **100** | 50 |
| | **1,846** | 3,201 |

Further details of Directors' remuneration are disclosed within the Remuneration Report.

### Transactions with other related parties

During the year the Group purchased customer care related services from Asert LLP, a company in which Mears Group PLC is a 50% partner, totalling £0.1m (2013: £0.1m). The Group also recharged costs totalling £0.1m to Asert LLP at cost. At 31 December 2014 the Group was owed £0.3m (2013: £0.2m) by Asert LLP.

During the year the Group also purchased call centre related services from Mears 24/7 LLP, a company in which Mears Limited is a 50% partner, totalling £1.9m (2013: £1.9m). The Group also recharged costs totalling £0.8m to Mears 24/7 LLP at cost. At 31 December 2014 the Group owed £0.1m (2013: £0.3m) to Mears 24/7 LLP.

# Principal accounting policies – Company

## Basis of preparation
The financial statements have been prepared in accordance with applicable United Kingdom accounting standards and under the historical cost convention other than financial instruments which are held at fair value.

The principal accounting policies of the Company are set out below. The following accounting policies have remained unchanged from the previous year.

## Investments
Investments are included at cost net of any provision for impairment.

## Goodwill
Goodwill representing the reallocation of amounts previously classed as investments upon the hive-across of trade and assets is capitalised and amortised on a straight-line basis over its estimated useful economic life.

## Share-based employee remuneration
All share-based payment arrangements that were granted after 7 November 2002 are recognised in the financial statements.

The Group operates equity-settled share-based remuneration plans for its employees. All employee services received in exchange for the grant of any share-based remuneration are measured at their fair values. These are indirectly determined by reference to the fair value of the share options awarded. Their value is determined at the date of grant and is not subsequently remeasured unless the conditions on which the award was granted are modified. The fair value at the date of the grant is calculated using the Binomial and Monte Carlo option pricing models and the cost is recognised on a straight-line basis over the vesting period. Adjustments are made to reflect expected and actual forfeitures during the vesting period.

Share-based remuneration in respect of employees of the Company is ultimately recognised as an expense in the Profit and Loss Account with a corresponding credit to share-based payment reserve. The Group operates share-based remuneration plans for employees of subsidiaries using the Company's equity instruments. The fair value of the compensation given in respect of these share-based compensation plans less payments received from subsidiaries in respect of those share-based payments is recognised as a capital contribution.

Upon exercise of share options, the proceeds received net of any directly attributable transaction costs up to the nominal value of the shares issued are allocated to share capital with any excess being recorded as share premium.

## Deferred taxation
Deferred tax is recognised on all timing differences where the transactions or events that give the Company an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred by the balance sheet date. Deferred tax assets are recognised where it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the balance sheet date.

## Retirement benefits
### i) Defined contribution pension scheme
The pension costs charged against profits are the contributions payable to individual policies in respect of the accounting period.

### ii) Defined benefit pensions
The Company contributes to one defined benefit scheme.

A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligations for any benefits from this kind of pension plan remain with the Company.

Scheme assets are measured at fair values. Scheme liabilities are measured on an actuarial basis using the projected unit method and are discounted at appropriate high quality corporate bond rates that have terms to maturity approximating to the terms of the related liability. Appropriate adjustments are made for past service costs. Past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that benefits are already vested, the Group recognises past service cost immediately.

## Retirement benefits continued

### ii) Defined benefit pensions continued

Actuarial gains and losses are recognised immediately through the Statement of Total Recognised Gains and Losses. The net surplus or deficit is presented with other net assets on the Parent Company Balance Sheet, net of any related deferred tax balance. A surplus is recognised only to the extent that it is recoverable by the Company.

The Company's contributions to the scheme are paid in accordance with the rules of the schemes and the recommendations of the actuary.

## Financial instruments

### Financial liabilities

The Company's financial liabilities are overdrafts, borrowings, other creditors and contingent consideration. They are included in the Consolidated Balance Sheet line items 'Creditors: amounts falling due within one year' and 'Creditors: amounts falling due after more than one year'.

All interest related charges are recognised as an expense in 'Finance cost' in the Profit and Loss Account with the exception of those that are directly attributable to the construction of a qualifying asset which are capitalised as part of that asset.

Bank and other borrowings are initially recognised at fair value net of transaction costs. Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance revenue and finance costs. Borrowing costs are recognised as an expense in the period in which they are incurred with the exception of those which are directly attributable to the construction of a qualifying asset which are capitalised as part of that asset.

Contingent consideration is initially recognised at fair value and is subsequently measured at fair value through the Profit and Loss Account.

### Derivative financial instruments

The Company uses derivative financial instruments to hedge its exposure to interest rate risks arising from operational and financing activities.

Derivative financial instruments are recognised initially and subsequently at fair value, with mark-to-market movements recognised in the Profit and Loss Account except where cash flow hedge accounting is applied (see below).

The fair value of interest rate swaps is the estimated amount that the Company would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments. Mark-to-market movements on these derivatives are shown in the Profit and Loss Account.

### Hedge accounting for interest rate swaps

Where an interest rate swap is designated as a hedge of the variability in cash flows of an existing or highly probable forecast loan interest payment, the effective part of any valuation gain or loss on the swap instrument is recognised through the statement of total recognised gains and losses in the hedging reserve. The cumulative gain or loss is removed from equity and recognised in the Profit and Loss Account at the same time as the hedged transaction. The ineffective part of any gain or loss is recognised in the Profit and Loss Account immediately.

When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer probable, the cumulative unrealised gain or loss recognised in equity is recognised in the Profit and Loss Account immediately.

# Parent Company balance sheet

As at 31 December 2014

| | Note | 2014 £'000 | 2013 £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Intangible assets: goodwill | 5 | **969** | 1,938 |
| Investments | 6 | **80,123** | 80,123 |
| | | **81,092** | 82,061 |
| **Current assets** | | | |
| Debtors | 7 | **81,103** | 96,972 |
| Cash at bank and in hand | | **694** | — |
| | | **81,797** | 96,972 |
| **Creditors:** amounts falling due within one year | 8 | **(6,542)** | (30,077) |
| **Net current assets** | | **75,255** | 66,895 |
| **Total assets less current liabilities** | | **156,347** | 148,956 |
| **Creditors:** amounts falling due after more than one year | 9 | **(57,900)** | (55,879) |
| **Provisions for liabilities** | | | |
| Pension liability | 14 | **(4,818)** | (3,173) |
| | | **93,629** | 89,904 |
| **Capital and reserves** | | | |
| Called up share capital | 10 | **1,011** | 1,007 |
| Share premium account | 11 | **56,714** | 56,082 |
| Share-based payment reserve | 11 | **1,653** | 1,050 |
| Hedging reserve | 11 | **(962)** | (848) |
| Profit and loss account | 11 | **35,213** | 32,613 |
| **Equity shareholders' funds** | | **93,629** | 89,904 |

The financial statements were approved by the Board of Directors on 17 March 2015.

**R Holt**
**Director**

**A C M Smith**
**Director**

The accompanying accounting policies and notes form an integral part of these financial statements.

Company number: 03232863

# Notes to the financial statements – Company



## 1. Profit for the financial year

The Parent Company has taken advantage of Section 408 of the Companies Act 2006 and has not included its own profit and loss account in these financial statements. The Group profit for the year includes a profit of £14.1m (2013: loss of £1.2m) which is dealt with in the financial statements of the Company. This result is stated after charging auditor's remuneration of £58,000 relating to audit services and £4,000 relating to taxation services.

## 2. Directors and employees

**Employee benefits expense**

All staff costs relate to Directors. Staff costs during the year were as follows:

| | **2014 £'000** | 2013 £'000 |
|---|---|---|
| Wages and salaries | **1,276** | 1,963 |
| Social security costs | **285** | 1,003 |
| Other pension costs | **185** | 185 |
| | **1,746** | 3,151 |

The average number of employees of the Company during the year was:

| | **2014 Number** | 2013 Number |
|---|---|---|
| Office and management | **9** | 10 |

## 3. Share-based employee remuneration

As at 31 December 2014 the Group maintained five share-based payment schemes for employee remuneration. The details of each scheme are included within note 5 to the consolidated financial statements.

All share-based employee remuneration will be settled in equity. The Group has no legal obligation to repurchase or settle the options.

In total, £0.1m of employee remuneration expense has been included in the Company's Profit and Loss Account for 2014 (2013: £0.1m), which gave rise to additional paid-in capital. No liabilities were recognised due to share-based payment transactions.

## 4. Dividends

The following dividends were paid on ordinary shares in the year:

| | **2014 £'000** | 2013 £'000 |
|---|---|---|
| Final 2013 dividend of 6.30p (2013: final 2012 dividend of 5.70p) per share | **6,370** | 5,617 |
| Interim 2014 dividend of 2.85p (2013: interim 2013 dividend of 2.50p) per share | **2,882** | 2,499 |
| | **9,252** | 8,116 |

The proposed final 2014 dividend of 7.15p per share has not been included within the financial statements as no obligation existed at 31 December 2014.

# Notes to the financial statements – Company continued

## 5. Goodwill

| | Goodwill £'000 |
|---|---|
| **Cost** | |
| **At 1 January 2014 and at 31 December 2014** | **6,196** |
| **Amortisation** | |
| At 1 January 2014 | 4,258 |
| Charge for the year | 969 |
| **At 31 December 2014** | **5,227** |
| **Net book value** | |
| **At 31 December 2014** | **969** |
| At 31 December 2013 | 1,938 |

Details of the impairment review undertaken at 31 December 2014 are included in note 11 to the consolidated financial statements.

## 6. Fixed asset investments

| | Investment in subsidiary undertakings £'000 | Loans £'000 | Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| **At 1 January 2014 and at 31 December 2014** | **58,123** | **22,000** | **80,123** |

Details of the principal subsidiary undertakings of the Company are shown in note 14 to the consolidated financial statements.

## 7. Debtors

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Amounts owed by Group undertakings | **75,983** | 92,375 |
| Prepayments and accrued income | **1,124** | 1,343 |
| Other debtors | **3,000** | 3,000 |
| Corporation tax asset | **738** | — |
| Deferred tax asset | **258** | 254 |
| | **81,103** | 96,972 |

The deferred tax asset above of £0.3m is due after more than one year. The recoverability of the deferred tax asset is dependent on future taxable profits. The Company expects to realise sufficient profits to enable the deferred tax asset to be recovered.

## 8. Creditors: amounts falling due within one year

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Bank loan | **5,000** | 25,000 |
| Bank overdraft | **—** | 3,673 |
| Other creditors | **19** | 40 |
| Accruals | **1,523** | 1,364 |
| | **6,542** | 30,077 |

Included within accruals is £1.5m (2013: £1.4m) relating to an interest rate hedge.

## 9. Creditors: amounts falling due in more than one year

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Bank loan | **57,500** | 55,000 |
| Other creditors | **400** | 879 |
| | **57,900** | 55,879 |

The Company has disclosed core bank borrowings of £57.5m as due in two to five years. Whilst the amounts borrowed could be repaid each quarter, the Company's intention is to align core bank borrowings with its interest rate swaps.

Included in other creditors is £0.4m (2013: £0.9m) relating to deferred consideration on acquisitions.

## 10. Share capital

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| **Allotted, called up and fully paid** | | |
| At 1 January 100,661,649 (2013: 91,859,911) ordinary shares of 1p each | **1,007** | 919 |
| Issue of nil (2013: 6,368,069) shares as a share placement | **—** | 64 |
| Issue of 472,493 (2013: 2,433,670) shares on exercise of share options | **4** | 24 |
| At 31 December 101,134,142 (2013: 100,661,649) ordinary shares of 1p each | **1,011** | 1,007 |

During the year, 472,493 (2013: 2,433,670) ordinary 1p shares were issued in respect of share options exercised. The difference between the nominal value of £0.004m and the total consideration of £0.6m has been credited to the share premium account.

## 11. Share premium account and reserves

| | Share capital £'000 | Share premium account £'000 | Share-based payment reserve £'000 | Hedging reserve £'000 | Profit and loss account £'000 |
|---|---|---|---|---|---|
| At 1 January 2014 | 1,007 | 56,082 | 1,050 | (848) | 32,613 |
| Issue of shares | 4 | 632 | — | — | — |
| Share option charges | — | — | 670 | — | — |
| Exercise of share options | — | — | (67) | — | 67 |
| Cash flow hedge | — | — | — | (114) | — |
| Profit for the year | — | — | — | — | 14,120 |
| Equity dividends | — | — | — | — | (9,252) |
| Actuarial gain on defined benefit pension scheme net of deferred tax | — | — | — | — | (2,335) |
| **At 31 December 2014** | **1,011** | **56,714** | **1,653** | **(962)** | **35,213** |

# Notes to the financial statements – Company continued

## 12. Capital commitments

The Company had no capital commitments at 31 December 2014 or at 31 December 2013.

## 13. Contingent liabilities

The Company had no contingent liabilities at 31 December 2014 or at 31 December 2013.

## 14. Pensions

### Defined contribution schemes

The Company contributes to personal pension schemes of the Directors.

### Defined benefit scheme

The Company operates a defined benefit pension scheme for the benefit of certain employees of its subsidiary companies. The assets of the schemes are administered by trustees in a fund independent from the assets of the Company.

Costs and liabilities of the scheme are based on actuarial valuations. The actuarial valuations were reviewed and updated to 31 December 2014 by a qualified independent actuary using the projected unit method.

The principal actuarial assumptions at the balance sheet date are as follows:

| | **2014** | 2013 |
|---|---|---|
| Rate of increase of salaries – first year | **1.00%** | 1.00% |
| Rate of increase of salaries – second year | **2.20%** | 1.00% |
| Rate of increase of salaries – long term | **3.25%** | 3.35% |
| Rate of increase for pensions in payment – based on RPI with a cap of 5% | **3.15%** | 3.25% |
| Rate of increase for pensions in payment – based on RPI with a cap of 3% | **2.50%** | 2.55% |
| Discount rate | **4.00%** | 4.60% |
| Expected rates of return on investments | **4.00%** | 4.60% |
| Retail Prices inflation | **3.25%** | 3.35% |
| Consumer Prices inflation | **2.35%** | 2.45% |
| Life expectancy for a 65 year old male | **23 years** | 23 years |
| Life expectancy for a 65 year old female | **25 years** | 25 years |

The amounts recognised in the Parent Company Balance Sheet and major categories of plan assets as a percentage of total plan assets are:

| | **2014 £'000** | 2013 £'000 |
|---|---|---|
| Equities | **10,723** | 9,814 |
| Bonds | **2,475** | 2,085 |
| Cash | **550** | 368 |
| Group's estimated asset share | **13,748** | 12,267 |
| Present value of funded scheme liabilities | **(19,771)** | (16,283) |
| Funded status | **(6,023)** | (4,016) |
| Related deferred tax asset | **1,205** | 843 |
| Pension liability | **(4,818)** | (3,173) |

## 14. Pensions continued

### Defined benefit scheme continued

The amounts recognised in the Profit and Loss Account are as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Current service cost | **164** | 207 |
| Past service cost | **—** | — |
| Total operating charge | **164** | 207 |
| Net interest | **162** | 148 |
| Total charged to the result for year | **326** | 355 |

Changes in the present value of the defined benefit obligations are as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Present value of obligations at 1 January | **16,283** | 13,818 |
| Current service cost | **164** | 207 |
| Past service cost | **—** | — |
| Interest on obligations | **744** | 647 |
| Plan participants' contributions | **42** | 63 |
| Benefits paid | **(437)** | (382) |
| Actuarial gain arising from changes in demographic assumptions | **—** | (1,040) |
| Actuarial loss arising from changes in financial assumptions | **2,975** | 1,453 |
| Actuarial loss arising from liability experience | **—** | 1,517 |
| Present value of obligations at 31 December | **19,771** | 16,283 |

Changes in the fair value of the plan assets are as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Fair value of plan assets at 1 January | **12,267** | 10,196 |
| Expected return on plan assets | **582** | 499 |
| Employers' contributions | **1,155** | 1,147 |
| Plan participants' contributions | **42** | 63 |
| Benefits paid | **(437)** | (382) |
| Return on plan assets above that recorded in net interest | **139** | 744 |
| Fair value of plan assets at 31 December | **13,748** | 12,267 |

# Notes to the financial statements – Company continued

## 14. Pensions continued

**Defined benefit scheme** continued

The movements in the net pension liability and the amount recognised in the Balance Sheet are as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| Deficit in schemes at 1 January | (4,016) | (3,622) |
| Current service cost | (164) | (207) |
| Past service cost | — | — |
| Contributions | 1,155 | 1,147 |
| Other finance income | (162) | (148) |
| Actuarial gain arising from changes in demographic assumptions | — | 1,040 |
| Actuarial loss arising from changes in financial assumptions | (2,975) | (1,453) |
| Actuarial loss arising from liability experience | — | (1,517) |
| Return on plan assets above that recorded in net interest | 139 | 744 |
| Deficit in schemes at 31 December | (6,023) | (4,016) |

Cumulative actuarial gains and losses recognised in equity are as follows:

| | 2014 £'000 | 2013 £'000 |
|---|---|---|
| At 1 January | (6,396) | (5,210) |
| Actuarial gain arising from changes in demographic assumptions | — | 1,040 |
| Actuarial loss arising from changes in financial assumptions | (2,975) | (1,453) |
| Actuarial loss arising from liability experience | — | (1,517) |
| Return on plan assets above that recorded in net interest | 139 | 744 |
| Total at 31 December | (9,232) | (6,396) |

History of experience gains and losses are as follows:

| | 2014 £'000 | 2013 £'000 | 2012 £'000 | 2011 £'000 |
|---|---|---|---|---|
| Fair value of scheme assets | 13,748 | 12,267 | 10,196 | 8,305 |
| Net present value of defined benefit obligations | (19,771) | (16,283) | (13,818) | (13,097) |
| Net deficit | (6,023) | (4,016) | (3,622) | (4,792) |
| **Experience adjustments arising on scheme assets** | | | | |
| Amount | 139 | 744 | 514 | (631) |
| Percentage of scheme assets | 1.0% | 6.1% | 5.0% | (7.6%) |
| **Experience adjustments arising on scheme liabilities** | | | | |
| Amount | — | (1,517) | — | — |
| Percentage of scheme liabilities | — | (9.3%) | — | — |

The employer's contributions expected to be paid during the financial year ending 31 December 2015 amount to £1.2m.

## 15. Related party transactions

The Company has taken advantage of the exemption with FRS 8 not to disclose transactions with companies which are 100% owned by the Group.

# Five-year record (unaudited)



## Income Statement

| | 2014 £'000 | 2013 £'000 | 2012 £'000 | 2011 £'000 | 2010 £'000 |
|---|---|---|---|---|---|
| **Revenue by business segment** | | | | | |
| Social Housing | **714,733** | 742,479 | 504,686 | 415,000 | 379,400 |
| Care | **124,007** | 123,095 | 112,550 | 108,518 | 100,358 |
| Continuing activities | **838,740** | 865,574 | 617,236 | 523,518 | 479,758 |
| Discontinued activities | **—** | 32,632 | 62,289 | 65,453 | 44,177 |
| **Total sales revenue** | **834,740** | 898,206 | 679,525 | 588,971 | 523,935 |
| Gross profit | **225,041** | 227,960 | 184,305 | 174,764 | 150,533 |
| Operating profit before acquisition intangible amortisation and exceptional costs | **42,995** | 38,392 | 31,161 | 33,608 | 31,320 |
| Exceptional items | **—** | (25,493) | (2,877) | (3,094) | (2,450) |
| Operating profit | **30,667** | 2,039 | 20,323 | 22,731 | 18,751 |
| Profit for the year before tax | **29,677** | 277 | 18,199 | 20,582 | 16,352 |
| PBT before acquisition intangible amortisation and exceptional costs | **42,005** | 36,630 | 29,037 | 31,459 | 28,921 |
| **Earnings per share** | | | | | |
| Basic | **25.03p** | (1.21)p | 19.61p | 19.87p | 17.70p |
| Diluted | **24.65p** | (1.17)p | 18.85p | 19.03p | 16.57p |
| Normalised | **32.20p** | 28.06p | 25.60p | 26.01p | 23.38p |
| Dividends per share | **10.00p** | 8.80p | 8.00p | 7.50p | 6.75p |

## Balance Sheet

| | 2014 £'000 | 2013 £'000 | 2012 £'000 | 2011 £'000 | 2010 £'000 |
|---|---|---|---|---|---|
| Non-current assets | **268,818** | 233,960 | 225,964 | 149,923 | 146,639 |
| Current assets | **217,718** | 241,697 | 249,719 | 184,207 | 143,669 |
| Current liabilities | **(190,040)** | (222,506) | (231,934) | (169,004) | (133,119) |
| Non-current liabilities | **(102,034)** | (72,850) | (74,931) | (13,341) | (15,635) |
| **Total equity** | **194,462** | 180,301 | 168,818 | 151,785 | 141,554 |
| Cash and cash equivalents, end of year | **3,834** | (448) | (12,384) | (13,429) | (12,243) |

# Shareholder and corporate information

## Financial calendar

**Annual General Meeting**

3 June 2015

**Record date for final dividend**

12 June 2015

**Dividend warrants posted to shareholders**

2 July 2015

**Interim results announced**

18 August 2015

## Registered office

1390 Montpellier Court
Gloucester Business Park
Brockworth
Gloucester GL3 4AH

Tel: 01452 634600
www.mearsgroup.co.uk

## Company registration number

3232863

## Company Secretary

**Ben Westran**

1390 Montpellier Court
Gloucester Business Park
Brockworth
Gloucester GL3 4AH

Tel: 01452 634600

## Bankers

**Barclays Bank PLC**

Wales and South West
Corporate Banking
4th Floor, Bridgewater House
Counterslip
Finzels Reach
Bristol BS1 6BX

Tel: 0800 285 1152

**HSBC Bank plc**

West & Wales
Corporate Banking Centre
3 Rivergate
Temple Quay
Bristol BS1 6ER

Tel: 0845 583 9796

## Solicitors

**BPE**

St James' House
St James' Square
Cheltenham GL50 3PR

Tel: 01242 224433

## Auditor

**Grant Thornton UK LLP**

Registered Auditor
Chartered Accountants
Hartwell House
55–61 Victoria Street
Bristol BS1 6FT

Tel: 0117 305 7600

## Financial adviser

**Investec Bank PLC**

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London EC2V 7QP

Tel: 020 7597 2000

## Joint corporate brokers

**Liberum Capital Limited**

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25 Ropemaker Street
London EC2Y 9LY

Tel: 020 7418 8900

**Peel Hunt**

Moor House
20 London Wall
London EC2Y 5ET

Tel: 020 7418 8900

## Registrar

**Neville Registrars Ltd**

Neville House
18 Laurel Lane
Halesowen
West Midlands B63 3DA

Tel: 0121 585 1131

## Investor relations

**Buchanan**

107 Cheapside
London EC2V 6DN

Tel: 020 7466 5000

## Internet

The Group operates a website which can be found at www.mearsgroup.co.uk. This site is regularly updated to provide information about the Group. In particular all of the Group's press releases and announcements can be found on the site.

## Registrar

Any enquiries concerning your shareholding should be addressed to the Company's Registrar. The Registrar should be notified promptly of any change in a shareholder's address or other details.

## Investor relations

Requests for further copies of the Annual Report and Accounts, or other investor relations enquiries, should be addressed to the registered office.

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