MACFARLANE
GROUP

Annual Report and Accounts 2016

- 2016 profit in line with expectations
- Packaging Distribution operating profit up 16%
- EBITDA in excess of £11m
- Innovation Lab opened in Q2 2016
- Recent acquisitions performing well
- Full year dividend of 1.95p per share

Strategic review

Governance

Financial statements

Shareholder information


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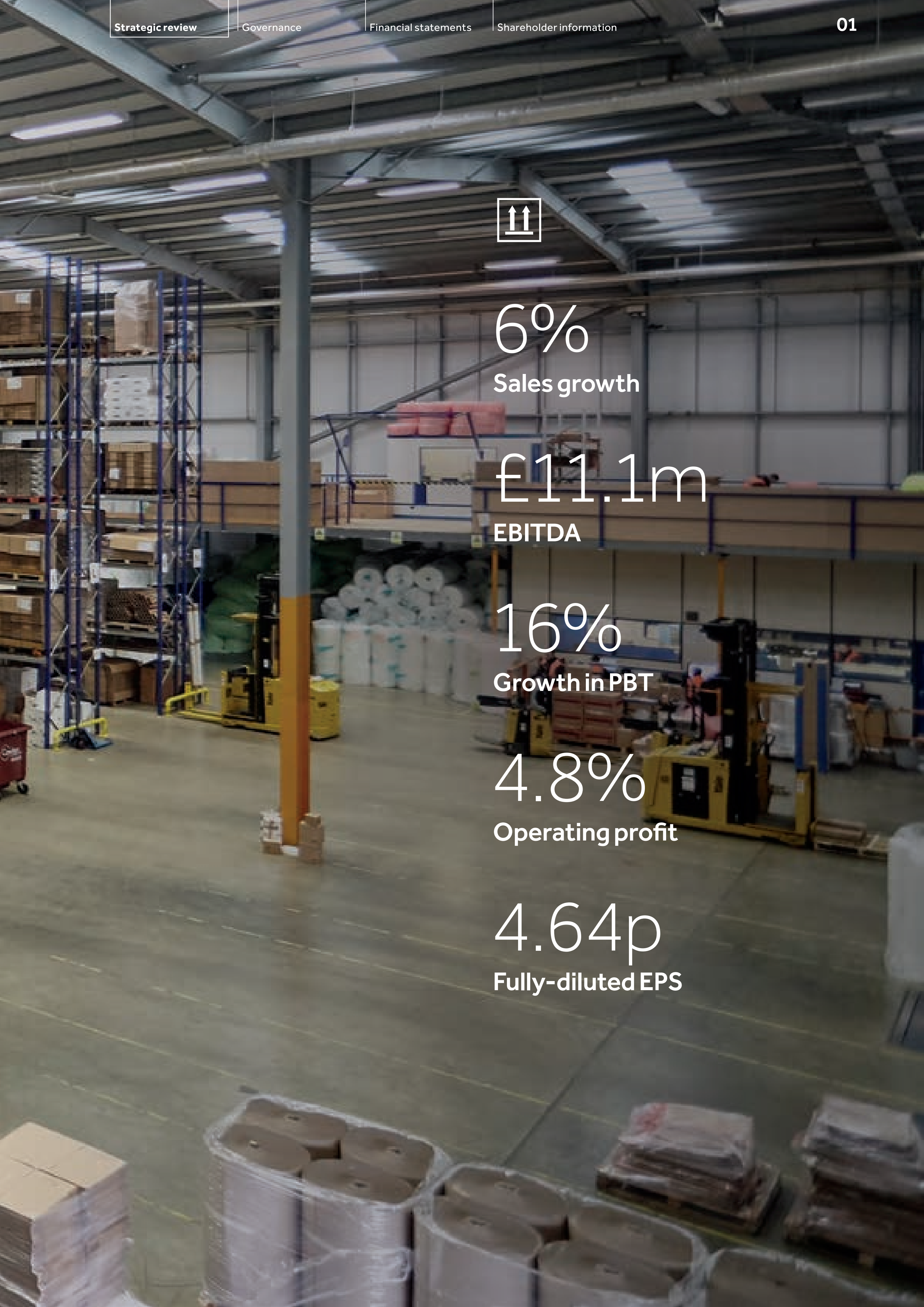


6%
Sales growth

£11.1m
EBITDA

16%
Growth in PBT

4.8%
Operating profit

4.64p
Fully-diluted EPS

Macfarlane Group business model

We design, manufacture and distribute protective packaging products and labels to business users. Protective packaging products are sold to customers in the UK. Labels are sold to customers in the UK, Europe and the USA. For reporting purposes, we split the Group into two segments:

- Packaging Distribution; and
- Manufacturing Operations (Packaging Design and Manufacture and Labels)

We operate 20 Regional Distribution Centres (RDCs) providing a UK national network to support customers on a local, regional and national basis as well as 2 satellite sites linked to RDCs. We also have 4 manufacturing centres, 2 in Design and Manufacture and 2 in Labels. There is a central administration centre in Coventry, a Labels design centre in Sweden and Group head office in Glasgow.

Macfarlane Group has over 800 employees. Our sites range in size from over 100 employees at manufacturing locations to under 20 for smaller RDCs. The Group operates a decentralised structure for sales and operations supported by central functional teams covering key areas such as procurement, logistics, IT and finance.

How our business generates value

Macfarlane is the UK market leader in the distribution of protective packaging products. Macfarlane leverages its purchasing scale to cost-effectively source a comprehensive range of protective packaging products and adds value for the customer by providing independent advice on the most cost-effective choice of product and packing processes, and operating as a single-source supplier for these products on a Just In Time basis with tailored stock management programmes and electronic trading capability.

The manufacturing businesses utilise design, intellectual property and know-how to provide a bespoke service to support major manufacturing customers to cost-effectively protect their high-value products in storage and distribution and for FMCG customers to attractively display and accurately identify their products at the point of sale.

Macfarlane aims to grow its business by increasing the penetration of existing customers and winning new customers. There will be a natural churn of packaging requirements with our existing customers and we experience a level of sales erosion each year as we optimise the protective packaging usage of our customers. Therefore new business generation is key to Macfarlane Group's overall growth and there is specific measurement and focus on this area.

MACFARLANE PACKAGING

Macfarlane Packaging Distribution is the UK market leader in the distribution of protective packaging products and contributes 87% of Group Revenue.

Market sectors served

- Internet retail
- Third party logistics (3PL)
- Electronics
- Aerospace
- Automotive

MACFARLANE PACKAGING DESIGN AND MANUFACTURE

Macfarlane Packaging Design and Manufacture provides a bespoke service to support major manufacturing customers to cost-effectively protect their high-value products in storage and transit and contributes 5% of Group Revenue.

Market sectors served

- Electronics
- Aerospace
- Automotive

MACFARLANE LABELS

Macfarlane Labels enables FMCG customers to attractively display and accurately identify their products at the point of purchase or sale and contributes 8% of Group Revenue.

Market sectors served

- Health and beauty
- Food
- Household goods
- Pharmaceutical

Our strategy

For many years we have followed a consistent strategy to **create value for shareholders**.

We seek to operate in markets which give above-average growth opportunities to develop business with our existing customers and generate business with new customers. At the same time we seek to improve the performance of the business by more effective sourcing and increasing the efficiency of our logistics and property portfolio. We then supplement this growth by acquiring quality businesses. The Group objective is to grow sales volumes and achieve a return on sales of at least 5%. The following table summarises the key strategic priorities:

Strategic priorities	2016 progress
1 Implementation of a segmental sales strategy to improve customer retention levels, increase product penetration and accelerate new business.	Continuing with our segmented approach has provided increased customer focus within Packaging Distribution. New Customer Service Centre established to enhance support of smaller local customers. Sales growth of 6% in 2016 reflects the success of our strategy.
2 Focus on key sectors with growth potential, particularly National Accounts and internet retail.	Our Innovation Lab was launched in the first half of 2016 and is proving an effective tool to demonstrate our capability to customers.
3 Enhance gross margins through focus on higher added value products and more effective sourcing.	Gross margins within Manufacturing Operations have improved due to the focus on sales of resealable labels. Both strategic and tactical purchasing programmes are in place to improve our sourcing capability.
4 Ensure operational effectiveness is maximised through efficiencies in logistics and optimising the costs associated with the physical infrastructure.	Logistics costs reduced to 2.7% (2015 – 2.9%) of sales through use of the Paragon planning tool and driver training. Property costs increased to 4.0% (2015 – 3.9%) of sales reflecting additional costs from acquisitions in our property network.
5 Supplement organic growth with suitable acquisitions.	We completed the acquisition of Colton Packaging Teesside ('Colton') in April 2016, the packaging business of Edward McNeil Limited ('McNeil') in May 2016 and Nelsons for Cartons & Packaging Limited ('Nelsons') in July 2016.

Chairman's statement

Macfarlane Group PLC made **further good progress in 2016** with sales of £179.8 million (2015 – £169.1 million) up 6% on the previous year and **profit before tax** of £7.8 million (2015 – £6.8 million), **15% up** on the previous year. The trading performance continued the positive trends achieved in recent years and the **results were in line with market expectations**.

Trading

The Packaging Distribution business increased sales by 9% to £155.9 million (2015 – £143.0 million). Organic sales growth was challenging in the first half of the year but strengthened in the second half of the year to 3%. This was supplemented by the contributions from Nelsons for Cartons & Packaging ('Nelsons'), acquired in July 2016, Colton Packaging

From left

Peter D. Atkinson
Chief Executive

Graeme Bissett
Chairman

Teesside ('Colton') and the packaging business of Edward McNeil ('McNeil') acquired in April 2016 and May 2016 respectively. Integration of these businesses has worked well and the combination of organic growth and the contributions from the acquired businesses resulted in Packaging Distribution achieving a 16% increase in operating profit to £7.8 million (2015 – £6.8 million).

Sales in our Manufacturing Operations at £23.9 million (2015 – £26.1 million) were 9% down on the previous year. This was mainly due to continued management actions to rebalance the mix of products in our Labels business, which positively impacted margins and resulted in Labels achieving good profit growth compared to 2015. Our Packaging Design and Manufacture business recovered from a poor first half of the year, but despite the recovery, the full year profit for Packaging Design and Manufacture was lower than in 2015. The overall Manufacturing Division operating profit in 2016 amounted to £0.9 million, slightly below the 2015 result of £1.0 million.

After charging interest of £0.9 million (2015 – £1.0 million), Group profit before tax amounted to £7.8 million (2015 – £6.8 million) an increase of 15%.

Dividend

The Board remains committed to providing shareholders with an appropriate return on investment and is proposing a final dividend of 1.40 pence per share, amounting to a full year dividend of 1.95 pence per share, a 7% increase on the prior year's dividend of 1.82 pence per share. Subject to the approval of shareholders at the Annual General Meeting on 9 May 2017, this dividend will be paid on 8 June 2017 to those shareholders on the register at 12 May 2017.

Net bank debt and pension scheme

As a consequence of the acquisitions undertaken during 2016, the Group's net bank borrowing at 31 December 2016 increased to £15.3 million from £11.6 million at the prior year-end. The Group's existing bank facility with Lloyds Banking Group of £25 million is available until June 2019 and accommodates normal working capital requirements as well as supporting acquisition funding. A further option is available to extend the facility to £30 million in the period.

The Group's pension deficit increased as a result of the widely reported fall in gilt yields which reduced the discount rate used to measure the pension scheme's liabilities. Whilst much of the increase in liabilities, resulting from the lower discount rate was offset by the scheme's holding in liability-driven investments, the deficit at 31 December 2016 rose by £3.0 million to £14.5 million (2015 – £11.5 million).

Outlook

The Board is confident that our strategy to position the business to serve key growth markets continues to be effective. The 15% increase in pre-tax profits in 2016 represents the seventh consecutive year of profit growth for Macfarlane Group and the Group has started 2017 well.

We will continue to focus on opportunities in sectors with strong growth prospects (including internet retail, third party logistics and National Accounts) and to deliver high standards of service to all our customers across a wide range of sectors. We will also maintain our programme of acquiring good quality businesses to augment organic growth.

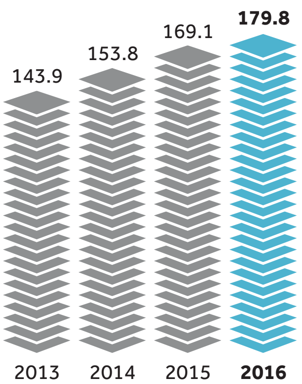
This is a strategy based on taking positive action which has served all stakeholders in our business well in recent years and we remain confident that it will continue to do so.

Graeme Bissett
Chairman

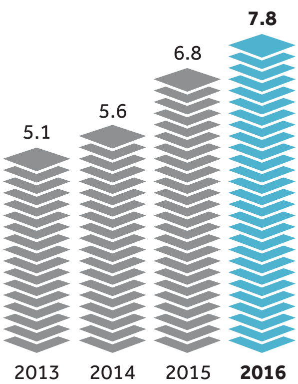
23 February 2017

Group performance

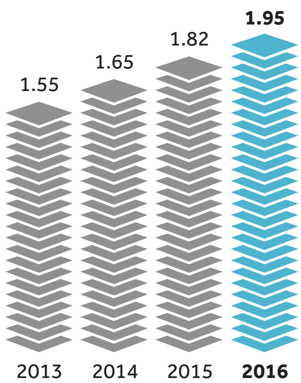
Sales (£m)



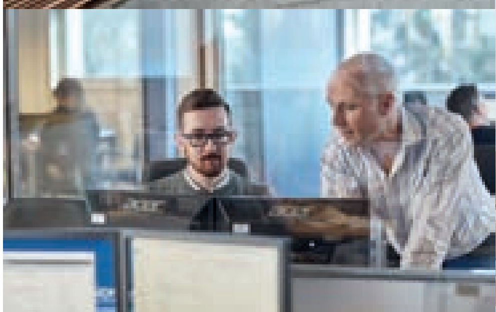
Profit before tax (£m)



Dividend (p)

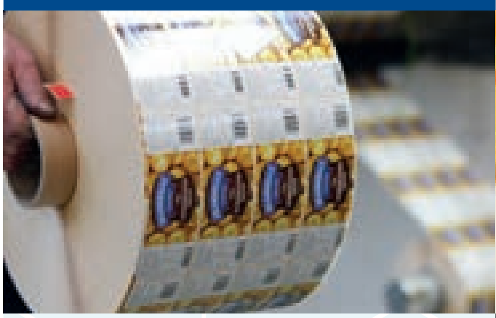


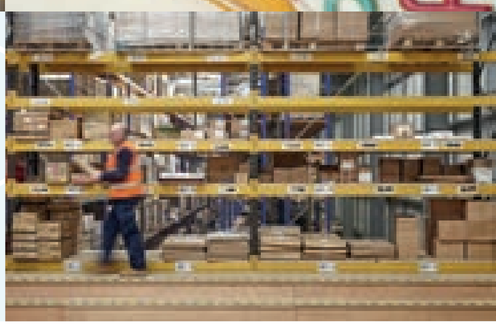
Our business in action

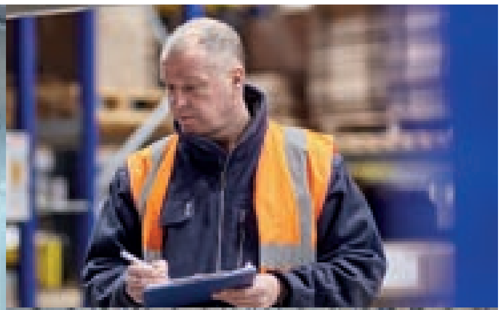


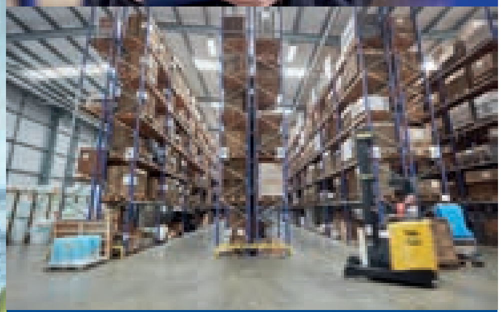
194 million

Reseal-it labels pre-applied in 2016





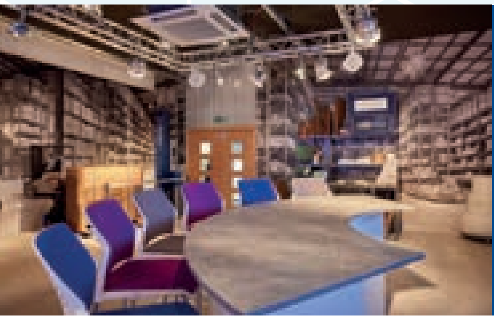




1,350

bespoke designs in 2016

Headquartered in Glasgow, **Macfarlane Group PLC** employs over 800 people at 27 sites across the UK, one site in Ireland and one site in Sweden and services more than 20,000 customers in a wide range of sectors.



20,000

distribution customers

Chief Executive's review – Packaging Distribution

Macfarlane Packaging Distribution is the leading UK specialist distributor of protective packaging materials. In a highly fragmented market, Macfarlane operates from 20 Regional Distribution Centres (RDCs) supplying customers with a comprehensive range of protective packaging materials on a local, regional and national basis.

Competition in the distribution market is from local and regional protective packaging specialist companies and national/international distribution generalists who supply a range of products, including protective packaging materials. Macfarlane competes effectively on a local basis through its strong focus on and regular monitoring of customer service, its breadth and depth of product offer and through the recruitment and retention of staff with good local market knowledge. On a national basis Macfarlane Packaging has focus, expertise and a breadth of product and service knowledge all of which enables it to compete effectively against non-specialist packaging distributors.

Macfarlane Packaging benefits its customers by enabling them to ensure their products are cost-effectively protected in transit and storage through the supply of a comprehensive product range, single source supply, Just In Time delivery, tailored stock management programmes, electronic trading and independent advice on both packaging materials and packing processes.

Distribution

	Base business £000	Acquisition impact £000	2016 £000	2015 £000
Revenue	144,195	11,705	**155,900**	143,035
Cost of sales	(102,295)	(8,346)	**(110,641)**	(100,817)
Gross margin	41,900	3,359	**45,259**	42,218
Net operating expenses	(34,902)	(2,521)	**(37,423)**	(35,467)
Operating profit	6,998	838	**7,836**	6,751

2016 trading

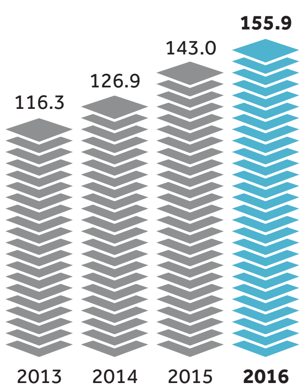
Macfarlane Packaging Distribution grew sales by 9% over 2015 comprising 1% organic growth in the base business and 8% from the contribution of the 2016 acquisitions of Nelsons, Colton and McNeil, as well as the incremental contribution from the 2015 acquisition of One Packaging Limited. The business achieved growth in the supply of protective packaging to internet retailers both directly and through our partnerships with major Third Party Logistics ('3PL') customers and the organic growth rate strengthened during the second half of 2016 to 3%. During 2016 we opened our new Innovation Lab which contributed to a number of new business wins in the second half of 2016. The Innovation Lab will play a key role in our sales growth plans in 2017 and beyond.

The changing mix of customers and input price increases on polymer-based products impacted gross margin, which at 29.0%, was slightly below the 29.5% achieved in 2015.

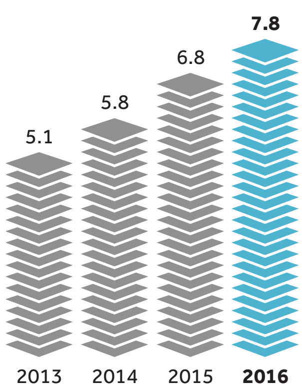
Net operating expenses increased as a result of the impact of acquisitions, but cost control remained strong with an improving overhead to sales ratio of 24.0% compared with 24.8% in 2015. Operating profit in the Packaging Distribution business at £7.8 million grew by 16% versus 2015.

Distribution performance

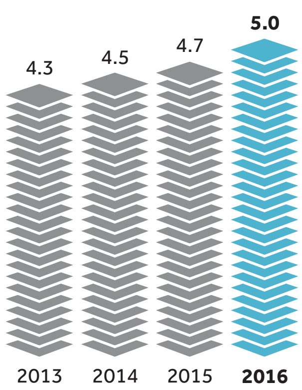
Sales (£m)



Operating profit (£m)



Return on sales (%)



Images from top

Macfarlane Packaging delivers from 20 RDCs in the UK.

Nelsons' Shelf Ready Packaging adds to our product portfolio.

The Innovation Lab was opened in Q2 2016.

Future plans

Our plans continue to be focused on those markets showing growth, building market share and improving profitability through the following actions:

- Maintaining our focus on the growth potential for protective packaging in our key market segments – the e-commerce sector, National Accounts and 3PL operators;
- Accelerating the growth in new business through effective use of our new Innovation Lab where we can fully showcase our Total Cost of Packaging solutions;
- Continuing to develop our web-based presence through www.macfarlanepackaging.com and our Customer Connect offering to improve online visibility and provide customers with a more effective way to access our full range of products and services;
- Integrating recently acquired businesses and companies following the completion of the respective earn-out periods;
- Supplementing organic growth through the identification and completion of further suitable high quality acquisition opportunities;
- Improving the awareness of our membership of NovuPak, for UK based customers requiring our capabilities on a wider European basis;
- Reducing operating costs by evaluating opportunities to consolidate the more fragmented parts of the existing property footprint;
- Improving our sourcing capabilities and our partnerships with key strategic suppliers;
- Implementing further operational savings in logistics by expanding the use of the Paragon vehicle management system and implementation of our warehouse best practice programme; and
- Maintaining the focus on working capital management to reduce borrowing levels.

Transacting with Macfarlane

Our new product catalogue is now available.

Our trading website **www.macfarlanepackaging.com** enables customers to place orders at their convenience 24 hours each day.

Chief Executive's review – Manufacturing Operations

Macfarlane's Manufacturing Operations comprise our Packaging Design and Manufacture business and our Labels business.

Design and Manufacture

The principal activity of the Packaging Design and Manufacture business is the design, manufacture and assembly of custom-designed packaging solutions for customers requiring cost-effective methods of protecting high value products in storage and transit. The primary raw materials are corrugate, timber and foam. The business operates from two manufacturing sites in Grantham and Westbury, supplying both directly to customers and also through the RDC network of the Packaging Distribution business.

Key market sectors are defence, aerospace, medical equipment, electronics and automotive. The markets in which we operate are highly fragmented with a range of locally based competitors. We differentiate our market offering through technical expertise, design capability, industry accreditations and national coverage through Macfarlane Packaging Distribution.

Manufacturing Operations

	2016 £000	2015 £000
Revenue	**23,872**	26,097
Cost of sales	**(13,418)**	(15,094)
Gross margin	**10,454**	11,003
Overheads	**(9,578)**	(10,052)
Operating profit	**876**	951

2016 trading

2016 sales for Packaging Design and Manufacture were 4% above those in 2015 albeit with volatile demand in certain market sectors. This caused changes to customers' ordering patterns, resulting in increased operating costs in the first half of the year. This resulted in 2016 profitability being below that achieved in 2015. However actions implemented in the second half of 2016 showed improved profitability and the business has created a strong pipeline of new customer relationships, which should benefit the business in 2017.

Future plans

The priorities for 2017 are:

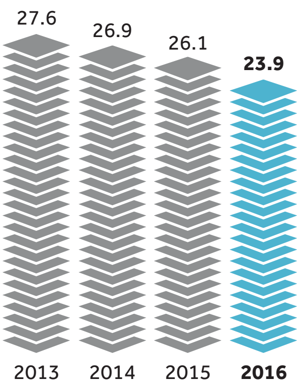
- Accelerate sales growth, particularly in target market sectors e.g. defence, aerospace and medical;
- Prioritise sales activity on the higher added-value bespoke composite pack product range; and
- Continue to strengthen the relationship between our Packaging Design and Manufacture operations and our Packaging Distribution business to create both sales and cost synergies.

Labels

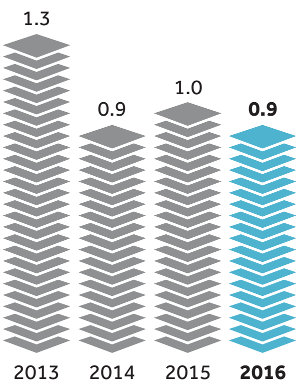
Labels designs and prints self-adhesive labels for major FMCG customers in the UK and Europe and resealable labels for major customers in the UK, Europe and the USA. The business operates from production sites in Kilmarnock and Wicklow and a sales and design office in Sweden, which focuses on the development and growth of our resealable labels business, Reseal-it.

Manufacturing Operations performance

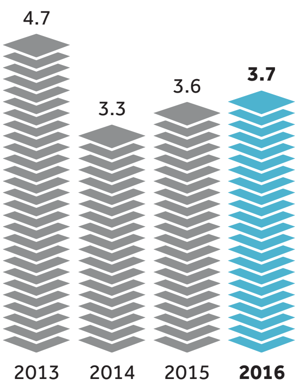
Sales (£m)



Operating profit (£m)



Return on sales (%)



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Self-adhesive labels for major FMCG customers.

Design, manufacture and assembly of custom-designed packaging solutions.

Easy to open packs are creating demand for resealable label products.

The Labels business has a high level of dependency on a small number of major customers. Management works closely with these key customers to ensure high levels of service and to introduce product and service development initiatives to achieve competitive differentiation.

2016 trading

Although sales in 2016 were 15% down on 2015, this was in line with our plans as we proactively exited relationships with lower margin customers, mainly in the lower added value and increasingly competitive self-adhesive labels market. As the issues of food waste and easy to open packs become higher profile, the demand for resealable packaging is creating growth opportunities for the Macfarlane Labels' Reseal-it range. This focus on Reseal-it resulted in improved margins in 2016 and was the key contributor to an improved profit performance compared to 2015.

Future plans

The priorities for Labels in 2017 are:

- Maintenance of the strategic focus on higher added value products and services to rebalance sales between our resealable and self-adhesive label ranges;
- Continued improvement in operational efficiency to mitigate sales price pressure; and
- Further development of the Reseal-it product in the US through the Printpack partnership, in Europe through new business wins and in the UK through penetration with key retailers.

2017 outlook

We will concentrate our sales efforts on those segments of the market, such as e-commerce, which are forecast to show continued above average growth rates and where customers recognise the real value of a specialist protective packaging distributor.

During 2017 we will look at opportunities for growth through the acquisition of good quality protective packaging businesses that improve our penetration of target market sectors, leverage our property footprint or improve our geographic coverage.

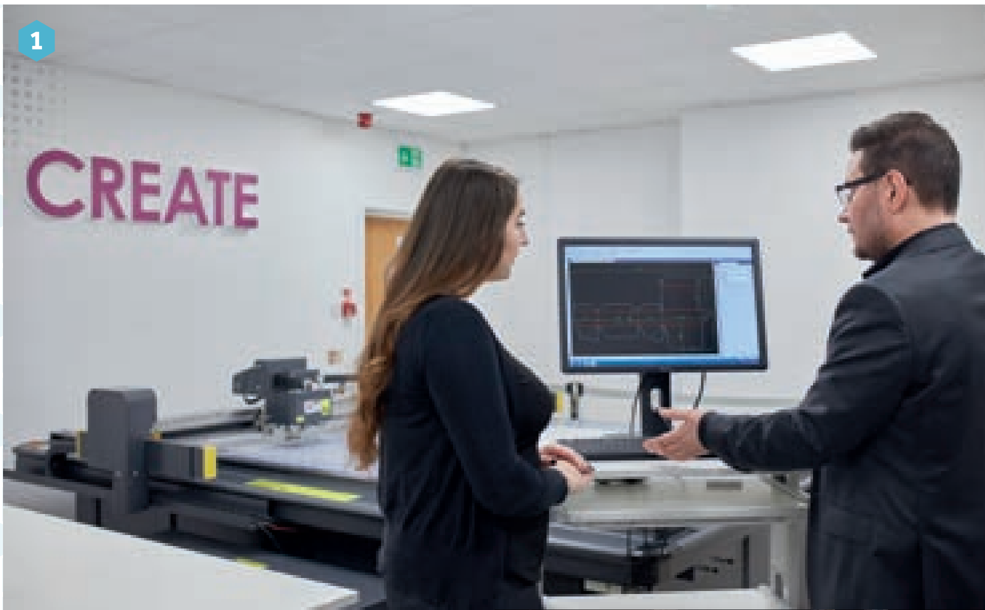
Macfarlane Group's businesses all have good market positions with strong differentiated product and service offerings. Our business model is flexible and we have a clear strategic plan, which is being effectively implemented, as reflected in our track record of consistent, profitable growth.

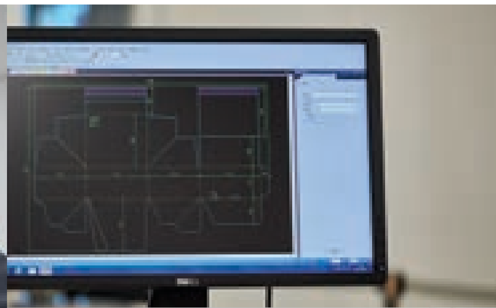
Our future performance will be largely dependent on our own efforts to grow sales, increase efficiencies and bring high quality acquisitions into the Group. We operate a flexible business model and our ability to focus on the most attractive UK market sectors for our products and services, combined with our successful track record of growth and acquisitions, gives us confidence that 2017 will be another year of progress for Macfarlane Group.

Peter D. Atkinson
Chief Executive

23 February 2017

Macfarlane Packaging Innovation Lab





Located in Milton Keynes, the Macfarlane Packaging Innovation Lab is a purpose built space to create solutions for the most demanding packaging challenges.

Innovation starts with the people who work for Macfarlane and the Innovation Lab has been designed to ensure that there are no bounds to their imagination when seeking out smart solutions for customers.

The Innovation Lab has been designed to problem-solve from start to finish in one location. It provides creative solutions that customers can see, touch and take away, saving them time and money in the packaging development process.

"Our Innovation Lab showcases leading-edge packaging design, equipment and tools to help create innovative packaging solutions to cost-effectively protect our customers' brands and products"

Peter D. Atkinson, Chief Executive

The customer innovation journey

1

The packaging problem
Typically Macfarlane customers will have a specific packaging challenge that they would like to address such as:
- reduce packaging cost
- reduce storage space and transport cost
- increase packaging efficiency
- reduce damage and returns
- improve customer experience

2

The innovation process
Macfarlane's sector teams will work collaboratively with the customer using the latest touchscreen technology, packaging design software, packing benches, machinery and consumables. This speeds up the process towards a printed sample or a fully modelled packaging solution.

3

The customer solution
The resultant sample packaging can then be shared and refined as required prior to formal packaging production sign off.

SELFRIDGES&Co

"I found my visit to the Innovation Lab a great success, not only with Selfridges' stakeholders, but also from Operations (third party fulfilment), Supply Chain, Marketing and Procurement who all attended. From the session we understood the total challenges and agreed actions and deadlines to de-risk our Christmas Come Early peak, whilst ensuring our packaging continues to represent the Selfridges brand in order to deliver the best customer experience. We will also benefit from using the Innovation Lab in the future for Selfridges' packaging workshops and training programmes."

Balwinder Sahota, Procurement Co-ordinator – Online, Foodhall & Restaurant

Selfridges customer experience

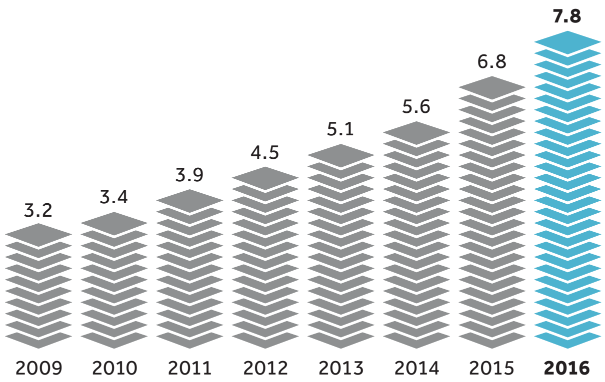
For their online packaging it is vital that the Selfridges brand identity has maximum impact. This is of particular importance to their international customer base who may never have visited a Selfridge's store before.

In this packaging solution the Selfridges plain box turns into a wow factor box when opened, giving an element of surprise and instant good feel factor about the brand. The packaging is as good as the product inside, showing that Selfridges care about their customers and their purchasing experience.

The Selfridges plain box turns into a wow factor box when opened.

Financial review

Profit before exceptional items (£)



2016 represents the Group's **seventh consecutive year of profit growth**.

Trading

The Group saw growth in sales of 6% during 2016, driven by our Packaging Distribution business and further enhanced by strong contributions from our recent acquisitions. Group sales rose to £179.8 million, an increase of £10.6 million from 2015. Profit before tax for 2016 increased to £7.8 million, an increase of £1.0 million from that achieved in 2015.

Taxation

The tax charge for the year from continuing operations was £1.8 million on profit before tax of £7.8 million, a rate of 22.5%, above the prevailing rate of 20.0% mainly due to acquisition costs incurred in 2016 not being deductible against corporation tax liabilities and adjustments in respect of prior period estimates. This compared with a tax charge of £1.3 million on the profit before tax of £6.8 million in 2015 and a tax rate of 19.5%.

Earnings per share

Diluted earnings per share totalled 4.64p (2015 – 4.35p) an increase of 7%, reflecting the growth in profitability.

The number of shares in issue at 31 December 2016 was 136,335,497, following the issue of 11,724,137 ordinary shares at the time of the acquisition of Nelsons for Cartons & Packaging Limited in July 2016.

Dividends

A dividend of 0.55p per share was paid on 13 October 2016. A further dividend of 1.40p per share is subject to approval by shareholders at the AGM in May 2017 and is not included as a liability in these financial statements.

Dividend cover has been maintained at 2.6 times. The Group continues to balance the aim to pay an attractive level of dividend against the need to retain funds in the business to finance acquisitions and capital expenditure.

Cash flow and net bank debt

The Group's debt facility with Lloyds Banking Group PLC comprises a three-year committed borrowing facility of up to £25.0 million for the period to June 2019, secured over part of Macfarlane Group's trade receivables. The facility bears interest at normal commercial rates and carries standard financial covenants in relation to interest cover and levels of headroom over trade receivables. There is an option to increase the facility further to £30.0 million. The facility accommodates increased working capital requirements from our organic growth as well as finance for pension scheme contributions and acquisitions. The Group's financing requirements are met by maintaining committed borrowing facilities.

The Group has been in compliance with the covenants in relation to the facility throughout 2016.

The Group had net bank borrowings of £15.3 million at 31 December 2016, an increase of £3.7 million from the previous year. The Group spent £8.7 million on acquisitions in 2016 (2015 – £3.9 million) and £1.1 million on capital expenditure in 2016 (2015 – £1.6 million). We will continue to invest where there are needs or opportunities to meet future growth plans. The Group will strive to ensure that in 2017, profit generation is, at the very minimum, matched by cash generation. The Group will remain prudent in its assessment of the likely returns from capital expenditure and potential acquisitions.

Acquisitions

During 2016 Macfarlane Group PLC acquired Colton Packaging Teesside, the packaging business of Edward McNeil and Nelsons for Cartons & Packaging Limited at a combined cash cost of £8.7 million. The Company completed a placing to part fund the acquisition of Nelsons for Cartons & Packaging Limited, raising £5.6 million.

During 2014 and 2015 the Company acquired Lane Packaging Limited, Network Packaging Limited and One Packaging Limited. For all three acquisitions, these were subject to earnout mechanisms and the maximum amounts due to the vendors of these companies has been paid in 2015 and 2016 with nothing further payable.

Market capitalisation and share price movements

At the year-end the Company's market capitalisation was £83.2 million, compared with £70.7 million last year. The share price at 31 December 2016 was 61.00p, compared with 56.75p at 31 December 2015. The range of transaction prices for Macfarlane Group shares during 2016 was 52.25p to 68.75p for each ordinary share of 25p.

Financial instruments

The Group's principal financial instruments comprise bank borrowings, cash balances and other items, such as trade receivables and trade payables that arise directly from its operations as well as shareholders' equity and contingent consideration arising from acquisitions. The main purpose of any financial instruments is to provide finance for the Group's operations. It is the Group's policy that no speculative trading in financial instruments is undertaken. The main risks arising are liquidity risk and credit risk and the secondary risks are interest rate risk and currency risk. The Board reviews and agrees policies for managing these risks, which have remained unchanged since the beginning of 2016 and these are set out in note 14 to the financial statements.

Pension scheme deficit

The Group's pension scheme deficit is sensitive to movements in bond yields, inflation, longevity assumptions and investment returns. The impact of these sensitivities is set out in note 24 to the financial statements.

The deficit rose by £3.0 million in the year, primarily due to the reduction in the discount rate used to measure liabilities. However the recent increase in the value of Liability-driven investments within the investment portfolio helped mitigate what could have been a larger increase.

Pension scheme deficit

	2016 £000	2015 £000	2014 £000
Fair value of scheme investments	**77,808**	67,793	67,990
Present value of scheme liabilities	**(92,345)**	(79,311)	(81,863)
Deficit at 31 December	**(14,537)**	(11,518)	(13,873)

The Board continues to take steps to reduce Macfarlane Group's pension deficit including regular deficit reduction contributions each year. This, combined with careful stewardship of the investment portfolio by the Trustees, in conjunction with the Company, has helped better match the investments with the scheme's liability profile.

Following the triennial actuarial valuation of the scheme at 1 May 2014, the Company agreed a new schedule of contributions with the Pension Scheme Trustees, which assumed a recovery plan period of 10 years. The next triennial actuarial valuation will be carried out at 1 May 2017.

International Financial Reporting Standards and accounting policies

As detailed in the 2015 Annual Report, the new International Financial Reporting Standards adopted during 2016 had no major impact on the disclosures and accounting policies in these financial statements. The Group continues to comply with all International Financial Reporting Standards adopted by the European Union.

Going concern

The Directors, in their consideration of going concern, have reviewed the Group's cash flow forecasts and profit projections, which are based on past experience and what they consider to be a prudent assessment of the market. The Group's business activities together with the factors likely to affect its future development, performance and financial position are set out in the Chairman's Statement and the Strategic Report on pages 2 to 23.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for at least the next twelve months. For this reason they continue to adopt the going concern basis in preparing the financial statements.

John Love
Finance Director
23 February 2017

Principal risks and uncertainties

The principal risks and uncertainties faced by the Group and the factors mitigating these risks are detailed on the following pages.

These risks are complemented by an overall governance framework including clear and delegated authorities, business performance monitoring and appropriate insurance cover for a wide range of potential risks. There is a dependence on good quality local management, which is supported by an investment in training and development and ongoing performance evaluation.

There are a number of other risks that we manage which are not considered to be key risks. In addition the Group is subject to the impact of general economic conditions, the competitive environment and risks associated with business continuity. These are all mitigated in ways that are common to all businesses and not specific to Macfarlane Group.

Viability statement

The Board of Directors has considered the Group's viability as part of the ongoing programme to manage risk. Each year the Board reviews the Group's strategic plan for the forthcoming three-year period and challenges the Executive team on the plan's risks. The plan reflects the Group's businesses, which have a broad spread of customers across a range of different sectors with some longer term contracts in place. The assessment period of three years has been chosen as it is consistent with the Board's review of the Group's strategy, which includes assumptions regarding future growth rates for existing businesses and acceptable levels of performance in that period. A robust financial model of the Group is built covering the three year period.

Risk

Raw material prices: The Group's businesses are impacted by commodity-based raw material prices and manufacturer energy costs, with profitability sensitive to supplier price changes including currency fluctuations. The principal components are corrugated paper, polythene films, timber and foam, with changes to paper and oil prices having a direct impact on the price we pay to our suppliers.

Funding defined benefit pension scheme: The Group's defined benefit pension scheme is sensitive to a number of key factors; investment returns, discount rates used to calculate scheme liabilities and mortality assumptions. The IAS 19 valuation of the Group's defined benefit pension scheme as at 31 December 2016 estimated the scheme deficit to be £14.5 million, an increase of £3.0 million during 2016. Small changes in these assumptions could mean that the deficit increases.

Property: Given the multi-site nature of its business, the Group has a property portfolio comprising 3 owned sites and 29 leased sites of which 3 are sublet. This portfolio gives rise to risks in relation to ongoing lease costs, dilapidations and fluctuations in value.

Financial liquidity, debt covenants and interest rates: The Group needs continuous access to funding to meet its trading obligations and to support organic growth and acquisitions. There is a risk that the Group may be unable to obtain funds or that such funds will only be available on unfavourable terms. The Group's borrowing facility comprises a committed facility of up to £25.0 million, with an option to increase the facility further to £30.0 million. This includes requirements to comply with specified covenants, with a breach potentially resulting in Group borrowings being subject to more onerous conditions.

Decentralised structure: The Packaging Distribution business model reflects a decentralised approach with a high dependency on effective local decision-making. There is a risk that management control is less effective and local decisions do not meet overall corporate objectives.

Working capital: The Group has a significant investment in working capital in the form of trade receivables and inventories. There is a risk that this investment is not fully recovered.

Acquisitions: The Group's growth strategy includes acquisitions as demonstrated in recent years with the acquisition of several businesses. There is a risk that such acquisitions will not be available to the Group on acceptable terms in the future. There is also a risk that the acquisitions will not be successful due to the loss of key people or customers following the acquisition or the acquired business not performing at the level expected which could potentially lead to an impairment in the carrying value of the related intangible assets. There are also execution risks around the failure to successfully integrate the acquired business into the Group.

Mitigating factors

- The Group works closely with its supplier base to manage the scale and timing of price increases to end-users effectively. Our IT systems monitor and measure our effectiveness in recovering supplier price changes. Where possible, alternative supplier relationships are maintained to minimise supplier dependency. We work with customers to redesign packs and reduce packing cost to mitigate the impact of cost increases.

- The scheme was closed to new members in 2002.
- Benefits for active members were amended by freezing pensionable salaries at 30 April 2009 levels.
- Revaluation of deferred members' benefits has reflected Consumer Price Index as the inflation measure since 2010.
- A Pension Increase Exchange option is available to offer flexibility to pensioners in the current level of pension benefits and the rate of future increases.
- The investment profile is constantly reviewed to ensure a more accurate matching of investments and the liability profile of the scheme.

- Where a site is non-operational the Group seeks to assign, sell or sub-lease the building to mitigate the financial impact. If this is not possible, rental voids are provided on vacant properties taking into consideration the likely period of vacancy and incentives to re-let.

- The Group seeks to maintain an appropriate level of committed bank facilities that provides sufficient headroom above peak projected borrowing requirements. The Group continually monitors net bank debt and forecast cash flows to ensure that it will be able to meet its financial obligations as they fall due. Compliance with debt covenants is monitored on a monthly basis and sensitivity analysis is applied to forecasts to assess the impact on covenant compliance.
- The existing facility is in place until June 2019.

- A comprehensive management information system is maintained with key performance indicators monitored consistently and regularly with actions taken when required.

- Credit risk is controlled by applying rigour to the management of trade receivables by our credit control team, managed by a Credit Manager and subject to additional scrutiny from the Group Finance Director.
- Inventory levels and order patterns are regularly reviewed and risks arising from holding bespoke stocks are managed by obtaining order cover from customers.

- The Group carefully reviews potential acquisition targets, ensuring that the focus is on businesses which complement the existing Group product and sector profile and provide opportunity for growth. Having made a number of acquisitions in recent years, the Group has established due diligence and integration processes and procedures.
- In terms of monitoring post integration performance, the Group has a comprehensive management information system in place as referenced above.
- Goodwill and other intangible assets are tested for impairment on an annual basis and the results are set out in note 9.

Viability statement (continued)

The model is subject to sensitivity analysis which includes flexing a number of the main assumptions, namely: future revenue growth, gross margins, operating costs and working capital management. The results of flexing these assumptions, both individually and in aggregate, are used to determine whether additional bank facilities will be required during the three year period. The results indicated that no additional facilities would be required and assumed that the existing facilities, due for renewal in June 2019 would be renewed on current terms. The review and analysis also considers the principal risks facing the Group as described on the current and previous page, which could prevent the Group from achieving its strategic objectives and the potential impact these risks could have on the Group's business model, future performance, solvency and liquidity over the assessment period.

The Directors' assessment has been made with reference to the resilience of the Group and the strength of its financial position, the Group's current strategy, the Board's risk appetite and the Group's principal risks and how these are managed. Based on the assessment of these risks and the sensitivity analysis undertaken, the Directors have a reasonable expectation that the Group will continue to operate and meet its liabilities, as they fall due, for the next three years to December 2019.

Corporate responsibility

Macfarlane Group has a responsibility to ensure that through its business operations it impacts positively on society. In order to achieve this we have a series of three programmes focused on environmental care, improving the customer experience and increasing employee engagement.

Corporate Responsibility (CR) leadership comes from an internal committee consisting of members from a cross section of the Group led by the Director of Group Risk. The key objectives of the CR Committee are:

- To improve the awareness of CR across the Group;
- To develop and implement action plans that support the CR strategy;
- To ensure that CR becomes an integral part of daily operational activities; and
- To monitor and report on CR performance using agreed key performance indicators (KPIs).

The environment

Mandatory Greenhouse Gas Reporting 2016

Macfarlane Group is committed to reducing its greenhouse gas (GHG) emissions. This report outlines Macfarlane's GHG emissions for the year ended 31 December 2016.

Using an operational approach, Macfarlane Group identified its boundaries to ensure all of the activities and facilities for which it is responsible were being recorded and reported in line with Scope 1 and 2 of the Mandatory Greenhouse Gas Reporting regulation. Relevant data was provided to an independent consultant, Carbon Clear. The validity, accuracy and completeness of the data was audited by Carbon Clear and then used to calculate the GHG for Macfarlane Group. The calculations were completed in accordance with the main requirements of ISO-14064-1:2006 standard and deliver both absolute values and an intensity ratio for Macfarlane's emissions. Acquisitions made during 2016 have been included in GHG reporting, an assumption has been made regarding usage based on equivalent sites within the Group.

Macfarlane Group uses total turnover (£000) in the reporting period to calculate the intensity ratio, as this allows emissions to be monitored over time taking into account changes in the size of the company. This factor was chosen because it provides the greatest degree of accuracy and is the metric best aligned to business growth.

The results show that total gross GHG emissions in the period were 6,946 tonnes of CO_2e, (2015 – 6,848 tonnes) comprised of the following:

- **Direct Emissions (Scope 1)**
  4,856 tonnes of CO_2e – 70%
  (2015 – 4,315 tonnes – 63%)
- **Indirect Emissions (Scope 2)**
  2,090 tonnes of CO_2e – 30%
  (2015 – 2,533 tonnes – 37%)

Broken down by business unit the results were as follows:

- **Distribution**
  4,493 tonnes of CO_2e – 65%
  (2015 – 4,707 tonnes – 69%)
- **Manufacturing Operations**
  2,453 tonnes of CO_2e – 35%
  (2015 – 2,141 tonnes – 31%)

These results are shown in tables 1 and 2 and comparing year on year emissions data for the two years 2015 and 2016, overall emissions have increased by 98 tonnes which equates to an increase of 1.4%. The increase in emissions in 2016 has arisen primarily from the increase in Vehicle Fuel consumption.

Waste management

The recycling and recovery (landfill diversion) rate for 2016 across all sites was marginally down compared to 2015. This small decrease is not a reflection of increased landfill,

Table 1: Emissions data

Type of emissions	Activity	2016 Units	2015 Units	2016 Tonnes of CO_2e	2015 Tonnes of CO_2e
Direct (Scope 1)	Natural gas (kWh)	**2,276,232**	2,365,340	**419**	436
	Vehicle fuel (litres)	**1,670,170**	1,482,963	**4,361**	3,832
	Other	**48,750**	30,263	**76**	47
	Subtotal			**4,856**	4,315
Indirect (Scope 2)	Purchased electricity (kWh)	**5,072,629**	5,480,258	**2,090**	2,533
	Subtotal			**2,090**	2,533
Total gross emissions (tCO_2e)				**6,946**	6,848

Table 2: Emissions data – business segments

Business segment	Total gross GHG emissions 2016 Tonnes of CO_2e	2015 Tonnes of CO_2e	2016 Sales £000	2015 Sales £000	Carbon intensity 2016 tCO_2e/£000	2015 tCO_2e/£000
Packaging Distribution	**4,493**	4,707	**155,900**	143,035	**0.029**	0.033
Manufacturing Operations	**2,453**	2,141	**23,872**	26,097	**0.102**	0.082
Total	**6,946**	6,848	**179,772**	169,132	**0.039**	0.040

References The following source of the carbon emissions factors was used: '2016 Guidelines to Defra/DECC's GHG Conversion Factors for Company Reporting', Department for Environment, Food and Rural Affairs (DEFRA) and Department for Energy and Climate Change (DECC)

but a decrease in the volume of bulk recyclables collected at Distribution sites. The figures from Distribution also reflected changes to the waste streams of some acquisitions as well as consolidation of sites where one off costs and extra waste were evident.

Our goal to achieve a zero to landfill status was very close within our manufacturing sites with the recycling and recovery rate for 2016 over 99% with the majority of the waste separated for recycling at source.

Various initiatives e.g. recycling backing papers within Labels and new sources for sawdust waste at Grantham contributed to these positive results.

As the chart in table 3 shows there have been significant improvements in the recycling and recovery rate figures since 2009 and the current rates are considered exceptional for the packaging industry.

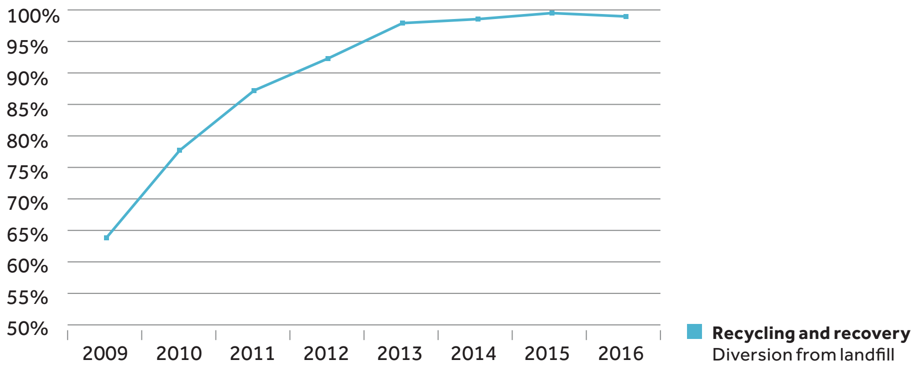
Waste expenditure was below budget, despite additional costs for small levels of hazardous waste, with additional revenues realised through the contract with Smurfit Kappa for baled cardboard which represents the largest waste type within the Group.

Our key environmental objectives for 2017 include;

- Cost/benefit feasibility analysis to explore a 100% landfill diversion option
- Increase the volumes of the paper backing recycling programme in Labels and support customers with this initiative
- Internal waste reduction programme utilising offcuts from the Packaging Design and Manufacture business
- Increase the recycling rates in the Packaging Distribution business
- Introduce the recent acquisitions to Cory with a view to managing waste streams more effectively

In the summer of 2016 our current waste provider, Cory Recycling Services Ltd was acquired by Reconomy. The company, now renamed Reconomy Environmental Recycling Services has committed to a programme of site audits and local toolbox talks on a regular basis to explore and drive through these objectives at site level. As part of our Supplier Audit Programme it is also our intention to benchmark Reconomy to ensure we are getting value for money and sound waste management advice for the Group.

Table 3: Recycling and recovery rate



Corporate responsibility (continued)

Environmental care

Macfarlane Group works in partnership with its customers and suppliers to ensure, at every opportunity, we provide an expert, independent and tailored approach, so that the products and services we provide take into consideration the impact on the environment.

One approach we take in order to achieve this is through an Environmental Product Matrix, produced in conjunction with our suppliers, which is consistent with the underlying need to ensure products are effectively protected in storage and transit. This Matrix enables our customers to choose packaging, which is fit for purpose, whilst ensuring they still embrace the Reduce, Re-use, and Recycle ethos.

To support our ongoing commitment to improve our environmental performance, we pursue the following objectives:

- To ensure compliance with all applicable environmental legislation and regulations;
- To reduce emissions' pollution;
- To improve waste management practices;
- To reduce the consumption of natural resources;
- To minimise noise and other nuisances; and
- To continuously assess our environmental performance.

These objectives are monitored by an internal, independent audit process, which provides visibility of a site's operational activities, and its adherence to legislative or company requirements. Environmental information is recorded, reviewed and analysed, by an identified team of individuals to ensure compliance with the Company's legal obligations and achievement of internal objectives and targets.

Table 4: Accident Frequency Rate (AFR)

Business segment	2016	2015	2014
Packaging Distribution	**0.42**	0.34	0.24
Manufacturing Operations	**1.11**	0.46	0.22
Group	**0.64**	0.38	0.23

The Group continues to make progress in its performance against the identified CR objectives. During 2017, the CR Committee will continue to review environmental performance, actively supporting methods or practices that contribute to the continued development of a culture driven by environmental responsibility.

Registration to ISO 14001

With the exception of certain recent acquisitions, all our UK packaging sites are registered to BSI ISO 14001 Environmental Management Standard. As an internationally recognised standard on environmental management, registration involves a process of continual assessment of our environmental standards and processes.

Health and safety

The health, safety and welfare of our people, including colleagues, customers and suppliers, forms a critical part of Macfarlane Group's business objectives. We aim to achieve a positive health and safety culture through the creation of a safe and healthy work environment, preventing and minimising risks. Our vision and goals for Health and Safety and how we commit to achieve them are based upon the best practice guidelines, issued by the Health and Safety Executive (HSE). To ensure we adhere and abide by best health and safety practices we have dedicated Health and Safety Managers in the business, who work with local Health and Safety teams to ensure knowledge and standards are effectively applied to the business on a consistent basis throughout all the health and safety disciplines.

To ensure constant and consistent focus regarding Health and Safety throughout the Group, it is a main agenda item at all formal monthly review meetings and operating sites in the Group are internally assessed and graded on their Health and Safety performance.

The Group Board plays a pivotal role in overseeing the operation of all Health and Safety. The Group Board reviews a report on Health and Safety at each meeting. This report covers incidents, near misses, reportable and non-reportable incidents.

The Accident Frequency Rate (AFR) representing the number of reportable incidents per 100,000 man-hours worked is shown in table 4 above.

In 2016, we experienced an increase in AFR vs. 2015. This represented nine reportable incidents compared to five in 2015. All reportable incidents are investigated thoroughly by our Health & Safety team and changes to working practices implemented if required. We also ensure that training in the particular area is reinforced. For example the increase in the AFR in 2016 is mainly due to slips, trips and falls and so, although we already deliver training in this area, we are in the process of reinforcing this further in 2017.

Table 5: Annual customer satisfaction scores

Business segment	2016	2015
Packaging Distribution	**89%**	87%
Packaging Design and Manufacture	**89%**	94%
Labels	**93%**	90%

Customer experience

Customer feedback

To continually improve our service to our customers, we use a range of metrics to evaluate our performance on an annual basis. In Packaging Distribution, we gain regular feedback from our customers throughout the year through Net Promoter Score (NPS) Surveys, Mystery Shopper and online Trust Pilot reviews. This insight is then used to improve products, processes and systems that interact with our customers. In addition, we continue to survey our customers in all of our businesses, on an annual basis, to evaluate our performance against a range of key service metrics with the summarised results shown in table 5 above.

Sales order management

Our online customer order management system, Customer Connect, and www.macfarlanepackaging.com is contributing to improvements in productivity as well as meeting the needs of our customers requiring more visibility of their packaging management. In the Packaging Distribution business in 2016, the value of sales transacted online has increased from 11.9% to 12.3%. In Packaging Distribution in 2016, orders transacted online decreased to 24% vs. 26% in 2015.

Electronic documentation

In 2016, 78% (2015 – 75%) of invoices to our customers were delivered electronically, further reducing our paper usage. The Group is continuing to encourage customers to receive documentation electronically. There is a pilot programme in the business to establish the optimum level of online transactions and this will then be rolled out across the business.

Macfarlane Group websites

Our family of websites enables existing and potential customers to research and evaluate our products and services and is a major contributor in generating new leads for the business. We will continue to invest in our websites to improve the experience for our customers and visitors and strengthen our value proposition.

Employee engagement

Macfarlane Group recognises the importance of recruiting, developing, rewarding and retaining the very best people to ensure our business continues to run successfully. Maintaining a working environment that promotes good employee relations, safety and employee engagement at all levels is critical to every Macfarlane operation.

Employee development

Macfarlane Group strives to make our workplace one in which individuals feel challenged, fulfilled and able to achieve their full potential. The Group invests in training in order to best equip individuals with the skills and knowledge required to provide an outstanding tailored service to our customers and fulfil their personal potential. On average, in 2016 each employee was engaged in 11 hours of formal training.

Macfarlane Group offers a wide range of training opportunities, ranging from external training and coaching to on-the-job training. This allows individuals to be stretched and challenged to achieve career objectives. The Company also provides Sponsored Further Education programmes, to support employee engagement in long-term education.

Corporate responsibility (continued)

Employee engagement

Employee engagement is an ongoing feature of our business. Through performance appraisals, business update sessions and informal review meetings a platform is provided for employee participation and involvement. Employee Surveys are conducted throughout the business providing a constructive method of feedback. In addition, and to support consistent employee engagement we run a number of forums, both role specific and business specific. These forums have worked to provide a voice for our employees, to engage in an open two-way dialogue and have their views/ideas heard.

Macfarlane Group provides interactive tools and resources to employees via mechanisms such as iPads providing employees with the ability to gain information, advise and provide feedback instantly, supporting the continued aim of enhancing the customer experience.

Table 6: Diversity

	2016		2015	
	Female	Male	Female	Male
Directors	**0**	**6**	0	6
Senior Managers	**4**	**12**	4	13
All other employees	**277**	**456**	278	463

Macfarlane Group encourages employees to engage with their local communities, supporting charities and activities that are having a positive impact in their region. During 2016 a number of Macfarlane teams engaged in events, providing support from both a resource and financial perspective. Each year Macfarlane Group makes a one off donation to a charity chosen by the workforce; for 2016 this was the Royal National Lifeboat Institution.

Diversity

A breakdown by gender of the Directors, Senior Managers and all other employees of the Group at 31 December 2016 is summarised in table 6.

Macfarlane Group websites

Business	Website domain	Target market/audience
Packaging Distribution	www.macfarlanepackaging.com	Wide range of businesses using packaging that need to protect their products during transit and storage.
Network Packaging	www.networkpack.co.uk	
One Packaging	www.onepack.co.uk	
Nelsons for Cartons & Packaging	www.nelsonsforcartons.co.uk	
Packaging Distribution Ireland	www.macfarlanepackaging.ie	
Packaging Design and Manufacture	www.macfarlanemanufacturing.com	Manufacturers of high value products in the aerospace, defence, electronics, medical and general industrial sectors.
Labels	www.macfarlanelabels.com	FMCG manufacturers and retailers in the food, health and beauty, household products, beverages and pharmaceutical industries.
Macfarlane Group	www.macfarlanegroup.com	Individuals seeking information on Group operations, Board procedures and financial performance for existing and potential investors.

Human rights

Macfarlane Group does not have a specific Human Rights policy at present but it does have other policies, which reflect established human rights' principles. These are:

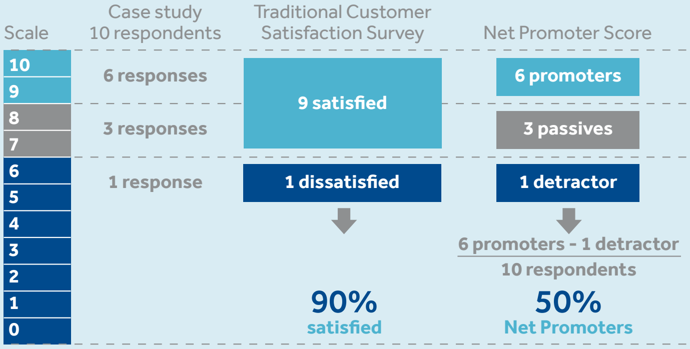
- Equality – Macfarlane Group is committed to providing equal opportunities in employment and to avoiding unlawful discrimination in recruitment, employment or to its customers and suppliers. Striving to ensure that the work environment is free of harassment and bullying and that everyone is treated with dignity and respect is an important aspect of ensuring equal opportunities in employment and there is a specific dignity at work policy, which deals with these issues.

  Where an employee becomes disabled every effort is made to ensure that their employment with the Group continues and that appropriate adjustments are made. Disabled employees receive equal opportunities regarding selection for training, career development and promotion.
- Engagement – Macfarlane Group recognises the importance of meaningful communication and consultation in maintaining good employee relations. This is achieved through formal and informal meetings across all business units as referred to earlier.
- Anti-bribery and corruption – Macfarlane Group has an anti-bribery and corruption policy, which is supplemented by a gift register and an associated policy on accepting gifts.
- Whistleblowing policy – there is provision for employees to use an independent service if they are not comfortable speaking to anyone within Macfarlane Group with regard to any matters which give them concern. This service is promoted throughout the Group.
- Modern Slavery Act – Macfarlane Group has now made a statement under the Modern Slavery Act which is supported by internal procedures to ensure that the principles of the act are adhered to. The statement is available on the website (www.macfarlanegroup.com).

Macfarlane Net Promoter Score

Net Promoter Score is an index ranging from -100 to 100 that measures the willingness of customers to recommend a company's products or services to others.

It is used as a proxy for gauging the customer's overall satisfaction with a company's product or service and the customer's loyalty to the brand. **Macfarlane's average net promoter score is 53, well above the average for B2B** (business to business) customers operating in markets with similar characteristics.



Board of Directors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1 Graeme Bissett
Chairman

Graeme Bissett joined the Board on 11 May 2004 as a Non-executive Director, becoming Chairman on 8 May 2012. He is Chairman of the Nominations Committee and a member of the Remuneration Committee. Graeme has previously served as finance director of international groups and as a partner with Arthur Andersen. His other board appointments comprise SMS plc, Anderson Strathern LLP, Curo Compensation Ltd, The Scottish Futures Trust Ltd and Cruden Holdings Ltd, together with a number of pro-bono appointments.

2 Peter Atkinson
Chief Executive

Peter joined Macfarlane Group as Chief Executive on 6 October 2003. He has a strong sales and marketing background through his career at Procter & Gamble and S.C. Johnson. Peter also has significant general management experience gained during his time at GKN PLC and its joint venture partners where he worked from 1988 to 2001 in a number of senior executive roles in their business-to-business operations. He has a successful track record of both business turnarounds and business development with extensive exposure to international business, having worked in the UK, Continental Europe and the USA. From 2000 to 2003, he was responsible for the US automotive and materials handling businesses of Brambles Industries PLC.

3 John Love
Finance Director

A member of The Institute of Chartered Accountants of Scotland, John has been with the Group for twenty years and was appointed Finance Director on 12 July 1999. He was with Deloitte and its predecessor firms for sixteen years before joining Macfarlane Group in 1996.

4 Mike Arrowsmith
Non-executive Director
(Senior Independent Director)

Mike joined the Board on 26 September 2012. He was Group Chief Executive of Linpac Group Ltd, a market-leading international food and consumer packaging company with annual sales of £1.1 billion, from 2005 to 2010. Prior to this he worked for Tibbett & Britten Group Plc, the £1.5 billion third party logistics group, from 1999 to 2005, joining the board in a senior commercial role before leading the transformation of the group as Chief Executive from 2001 to 2004 prior to its sale to Exel Plc. Mike served as a non-executive director of Enodis Plc from 2004 to 2008. He is currently a non-executive director of Tullis Russell Group Ltd and Chairman of Jas. Bowman & Sons Limited. Mike is a member of the Audit, Remuneration and Nominations Committees.

5 Bob McLellan
Non-executive Director

Bob McLellan joined the Board on 5 March 2013. Bob was Chief Executive of DS Smith Packaging UK until 2011, latterly as Deputy CEO Packaging (UK and Continental Europe). He has spent many years working in the packaging sector and holds leading roles in both the UK and Continental European industry employer associations. He is currently Chairman of the Logson Group and a non-executive director of Swanline Print Limited. Bob chairs the Remuneration Committee and is also a member of the Nominations and Audit Committees.

6 Stuart Paterson
Non-executive Director

Stuart Paterson joined the Board on 1 January 2013. He is a Chartered Accountant and is currently Chief Financial Officer at Forth Ports Limited, joining in March 2011 when it was listed on the London Stock Exchange. The company was acquired by Arcus Infrastructure Partners in June 2011. Prior to his current role, Stuart was Chief Financial Officer of Johnston Press PLC from 2001 to 2010 and previously worked in senior financial management roles at the electronics group Motorola Corporation, and then as Group Finance Director and then Managing Director Europe for Aggreko PLC, the global power hire group. He served as a non-executive director with Devro plc from 2006 to 2012, where he chaired the Audit Committee. Stuart is also a trustee of the Royal Yacht Britannia and a member of their Audit, Risk and Remuneration Committee. He succeeded Graeme Bissett as Chairman of the Audit Committee on 1 January 2013 and is also a member of the Remuneration and Nominations Committees.

Derek Quirk
Company Secretary

Derek Quirk joined Macfarlane Group in December 2015 as Director of Group Risk. He was appointed Company Secretary on 1 March 2016 and is a member of the Group's Executive Committee. He provides legal support and leads the Group's Internal Audit function. Prior to his current role, Derek was with BBA Aviation PLC for seven years, serving as Head of Group Internal Audit and latterly as Financial Controller for one of the company's divisions. He is a member of The Institute of Chartered Accountants of Scotland.

Corporate advisers

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Registered in Scotland

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Derek L.H. Quirk

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Report of the Directors

The Directors present their annual report and the audited financial statements of the Group for the year ended 31 December 2016. Pages 2 to 40 inclusive comprise the Directors' report, which in turn includes the Strategic Report on pages 2 to 23.

Corporate governance

The information that fulfils the requirement of the Corporate Governance Statement can be found in the Corporate Governance Section on pages 34 to 40 (and is incorporated into this report by reference) with the exception of the information referred to in the Financial Services Authority Disclosure and Transparency Rules 7.2.6, which is located within this report.

Report on greenhouse gas emissions

Details of the Group's emissions are contained within the Corporate Responsibility Report.

Cautionary statement

The Strategic Report on pages 2 to 23, which includes the Chairman's statement on pages 4 and 5, has been prepared to provide additional information to members of the Company to assess the Group's strategy and the potential for the strategy to succeed. It should not be relied on by any other party or for any other purpose.

This report and the financial statements contain certain forward-looking statements relating to operations, performance and financial status. By their nature, such statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future. There are a number of factors, including both economic and business risk factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements. These statements are made by the Directors in good faith based on the information available to them up to the time of their approval of this report.

Results and dividends

The Group's profit before tax from continuing activities was £7,811,000 (2015 – £6,767,000). This resulted in a profit for the year of £6,050,000 (2015 – £5,450,000).

The Directors declared an interim dividend of 0.55p per share, which was paid on 13 October 2016 (2015 – 0.53p per share). The proposed final dividend of 1.40p per share (2015 – 1.29p per share) is subject to approval by shareholders at the Annual General Meeting ('AGM') in May 2017 and has not been included as a liability in these financial statements.

Shareholder information

Capital structure

The Group funds its operations from a number of sources of cash, namely operating cash flow, bank borrowings, finance lease borrowings and shareholders' equity, comprising share capital, reserves and retained earnings, where appropriate. The Group's objective is to achieve a capital structure that results in an appropriate cost of capital whilst providing flexibility in immediate and medium-term funding so as to accommodate any material investment requirements.

Details of the issued share capital are shown in note 19. The Company issued 11,724,137 ordinary shares during 2016.

The Company has one class of ordinary share, which carries no right to fixed income. Each share carries the right to one vote at general meetings of the Company. There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the Articles of Association and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights.

The Company's banking facilities may, at the discretion of the lender, be repayable on a change of control.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

The Company is governed by its Articles of Association, the UK Corporate Governance Code and the Companies Act 2006 with regard to the appointment and replacement of Directors. The Articles may be amended by special resolution of the shareholders. The powers of the Directors are detailed in the Corporate Governance report on pages 34 to 40.

The Directors will propose an ordinary resolution at the 2017 AGM seeking authority to allot shares in the Company under section 551 of the Companies Act 2006 up to an aggregate nominal amount of £11,361,290.

At last year's AGM on 10 May 2016, the Directors were given authority to allot further ordinary shares, disapplying any pre-emption rights, beyond those committed to the share option schemes or long term incentive plans up to an aggregate nominal value of £3,115,824. That authority expires at the conclusion of the forthcoming AGM. A special resolution will again be put to shareholders to renew for a further year the authority over the existing unissued and uncommitted ordinary share capital of £3,408,387, representing 10% of the current share capital.

No authority will be sought at the 2017 AGM to enable the Company to purchase its own shares.

Employee share schemes

Details of the option awards under the Macfarlane Group PLC Long

Substantial holdings

	Number of shares held	Percentage
Funds held by Rights & Issues Investment Trust PLC	16,741,368	12.28%
Funds managed or advised by Miton Group PLC	15,365,237	11.27%
Funds managed by Hargreave Hale Limited	14,778,991	10.84%
Funds managed or advised by Unicorn Asset Management	6,850,362	5.03%
Funds held by MI Discretionary Unit Fund	4,500,000	3.30%

Term Incentive Plan are set out in the Report on Directors' Remuneration on page 29. The remaining option awards outstanding under the Company's Long Term Incentive Plan at 31 December 2016 are set out in note 25.

The Remuneration Committee supervises the grant of share incentives, which are only capable of being exercised if the performance conditions to which they are subject has been satisfied. The Remuneration Committee will specify the performance conditions at the time of the grant of the share incentive, having regard to the objectives of the Company and to market practice at the relevant time. A new Long Term Incentive Plan was approved by shareholders at the 2016 AGM. Further detail is given in the Report on Directors' Remuneration on pages 28 to 33.

Substantial holdings of shares in the Company

The Company has received notification prior to 23 February 2017 in accordance with Chapter 5 of the Disclosure and Transparency Rules of the following voting rights as a shareholder in the Company as set out in the table above.

Directors

The names of the Directors in office at 31 December 2016, who served throughout the year together with short biographical details, are set out on pages 24 and 25. The Board considers its three Non-executive Directors to be independent.

Peter Atkinson and Mike Arrowsmith retire by rotation at the AGM in May 2017 and offer themselves for re-election. Peter Atkinson has a service contract with the Company dated 6 October 2003 with a notice period of twelve months. Mike Arrowsmith has a letter of appointment with the Company dated 10 December 2015 with a notice period of three months. The Chairman, Graeme Bissett, offers himself for re-election on an annual basis, and will do so again this year.

No Director, either during or at the end of the financial year, had an interest in any contract relating to the business of the Company or any of its subsidiaries. The statement of Directors' interests in the ordinary share capital of Macfarlane Group PLC is contained in the Report on Directors' Remuneration on page 30.

There are no agreements between the Company and its Directors or employees that provide for compensation for loss of office or employment that occurs because of a takeover bid.

Directors' and officers' liability insurance

The Company has maintained Directors' and officers' liability insurance cover throughout the financial year. The Company has made qualifying third party indemnity provisions for the benefit of Directors which remain in force.

Political contributions

It is the Group's policy not to make donations for political purposes.

Special business

A special resolution will be put to shareholders to renew for a further year the authority in relation to the disapplication of pre-emption rights over the existing unissued and uncommitted ordinary share capital. This authority is limited to a maximum nominal amount of £3,408,387.

Disclosure of information to auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Independent auditor

There will be a resolution proposing the re-appointment of KPMG LLP as the Company's auditor at the forthcoming Annual General Meeting.

Company information

The Company is registered in Scotland (SC 004221) and its registered office is at 21 Newton Place, Glasgow, G3 7PY.

Approval

The Strategic Report on pages 2 to 23 and the Directors' Report on pages 26 to 40 were both approved by the Board on 23 February 2017.

Derek L.H. Quirk
Company Secretary
23 February 2017

Remuneration report

Remuneration Committee Chairman's summary statement

This Remuneration report has been drawn up under the provisions of the Enterprise and Regulatory Reform Act 2016. In addition to this statement the report includes two further sections detailing the Annual Report on Remuneration on pages 29 to 31 and key excerpts from the Remuneration Policy, which was approved at the 2016 AGM, on pages 32 and 33.

The Macfarlane Group PLC Long Term Incentive Plan was also approved at the 2016 AGM following an appropriate consultation process. Details are set out in the annual report on remuneration on page 31.

The Company has a Remuneration Committee constituted in accordance with the UK Corporate Governance Code. The Committee comprises three independent Non-executive Directors plus the Company Chairman, Graeme Bissett. The Committee determines the remuneration for the Executive Directors and also oversees the remuneration of the Chief Executive's direct reports.

The key components of executive remuneration are:

- Basic salary and benefits – the increase applied for 2017 is 2%, consistent with all eligible employees.
- Annual Bonus – there is a maximum payment of 50% of salary with 40% based on Profit before tax ('PBT') performance and 10% based on personal objectives. Bonuses for 2016 of £92,000 and £42,000, were awarded to Peter Atkinson and John Love respectively. The basis for this is detailed in the annual report on remuneration on page 29. These bonuses are paid in cash, following Board approval of the 2016 Annual Report and Accounts. Our policy allows for a bonus of up to 100% of salary, although the maximum for 2017 will remain at 50%.
- Pension – the Chief Executive receives a cash payment in lieu of pension contribution and the Finance Director is a member of the legacy defined benefit pension scheme for which pensionable salary was frozen in 2010.
- Long term incentives – there is a Performance Share Plan available which permits grants of shares up to 100% of salary with a three year performance period using EPS, TSR and sales performance conditions. On 8 May 2015, Peter Atkinson and John Love were granted option awards over 775,254 and 360,026 ordinary shares respectively under the Macfarlane Group PLC Long Term Incentive Plan. The performance conditions attached to these awards are set out in the annual report on remuneration on page 29.
- Total Directors' remuneration increased in 2016 by 3.5%.

The Group has made substantial progress in 2016 with profit before tax increasing by 15.4% and the share price increasing by 7.5% to 61.0p at 31 December 2016.

The Remuneration Committee recommends this report and I hope that you will feel able to support the resolution to approve the Report on Directors' Remuneration which will be proposed for approval at the Annual General Meeting on 9 May 2017.

Bob McLellan
Chairman of the Remuneration Committee
23 February 2017

Annual report on remuneration

Single total figure of remuneration for each Director

The details set out on pages 29 and 30 of this report, up to and including the Statement of Directors' shareholdings and share interests, have been audited by KPMG LLP.

2016	Salary and fees £000	Taxable benefits £000	Bonus £000	Pension costs £000	Total £000
Chairman					
G. Bissett	**64**	**–**	**–**	**–**	**64**
Executive Directors					
P.D. Atkinson	**334**	**16**	**92**	**74**	**516**
J. Love	**166**	**6**	**42**	**20**	**234**
Non-executive Directors					
M. Arrowsmith	**32**	**–**	**–**	**–**	**32**
S.R. Paterson	**32**	**–**	**–**	**–**	**32**
R. McLellan	**32**	**–**	**–**	**–**	**32**
Total	**660**	**22**	**134**	**94**	**910**

2015	Salary and fees £000	Taxable benefits £000	Bonus £000	Pension costs £000	Total £000
Chairman					
G. Bissett	62	–	–	–	62
Executive Directors					
P.D. Atkinson	328	16	92	72	508
J. Love	152	6	38	20	216
Non-executive Directors					
M. Arrowsmith	31	–	–	–	31
S.R. Paterson	31	–	–	–	31
R. McLellan	31	–	–	–	31
Total	635	22	130	92	879

Annual bonus for the year ended 31 December 2016

The bonus is based on performance against financial targets and personal objectives. The minimum financial target for 2016 was PBT of £7.4 million, which was achieved so a total bonus of £101,000 has been awarded for this component. The Remuneration Committee has also assessed performance against personal objectives and overall, has awarded bonuses of 7.5% and 5.0% of salary, equating to £25,000 and £8,000 to Peter Atkinson and John Love respectively. These bonuses are paid in cash following Board approval of the Group Accounts each year.

Directors' pension entitlements

Peter Atkinson receives a cash allowance which, including the related employer's national insurance contributions, equates to 25% of basic salary. John Love is a member of Macfarlane Group PLC Pension & Life Assurance Scheme (1974) and his accrued pension at 31 December 2016 was £41,000 (2015 – £39,000). The associated transfer value was £826,000 (2015 – £788,000) calculated using HMRC guidelines. The scheme's normal retirement date is 65 with no automatic entitlement to early retirement.

Scheme interest awards in 2016

On 8 May 2015, Peter Atkinson and John Love were granted option awards over 775,254 and 360,026 ordinary shares respectively under the Macfarlane Group PLC Long Term Incentive Plan. These awards are based on targets as follows:

(i) Total Shareholder Return, which is positive in the three years ending 7 May 2018; and
(ii) Sales for calendar year 2017 of at least £154 million; and
(iii) Earnings per share of between 5.75p and 6.53p in calendar year 2017 for vesting of between 25% and 100% of the award, calculated on a sliding scale.

Remuneration report (continued)

Statement of Directors' shareholding and share interests

	2016 Beneficial	2016 Option	2015 Beneficial	2015 Option
G. Bissett	**368,750**	**–**	343,750	–
P.D. Atkinson	**854,172**	**775,254**	854,172	775,254
J. Love	**800,000**	**360,026**	775,000	360,026
M. Arrowsmith	**100,000**	**–**	100,000	–
S.R. Paterson	**120,000**	**–**	100,000	–
R. McLellan	**102,819**	**–**	78,791	–

The remainder of the Annual report on remuneration is not subject to audit.

Performance graph and table

The following graph shows Macfarlane Group's performance, measured by Total Shareholder Return, compared with the performance of the FTSE All-Share Index for Support Services, also measured by Total Shareholder Return for the period since 1 January 2009. The Index for Support Services has been selected because it includes a range of companies, which the Remuneration Committee considers to be the best available comparison for the Group for this purpose.

CEO single figure

		Single figure of total remuneration £000	Annual variable element award vs. maximum opportunity	Long term incentive vesting against maximum opportunity
2016	**P.D. Atkinson**	**516**	**55%**	**n/a**
2015	P.D. Atkinson	508	56%	n/a
2014	P.D. Atkinson	586	46%	n/a
2013	P.D. Atkinson	416	10%	n/a
2012	P.D. Atkinson	462	45%	n/a
2011	P.D. Atkinson	390	10%	n/a

Percentage change in remuneration of CEO and employees

The following table shows the percentage change in remuneration between 2016 and 2015 for the CEO and for all employees in the Group.

% change in	CEO	Average for all eligible employees
Base salary	2%	2%
Benefits	0%	0%
Bonus	0%	(40%)

Relative importance of spend on pay

The difference in expenditure between 2015 and 2016 on remuneration for all employees in comparison to the distribution to shareholders by way of dividend is set out below:

	2016 £000	2015 £000	% change
Total employee pay	**24,299**	23,994	+1.3%
Dividend	**2,358**	2,094	+12.6%

Statement of implementation of remuneration policy in the current financial year

The salaries of the Chief Executive and the Finance Director were increased by 2% with effect from 1 January 2017. The fees paid to the Chairman and Non-executive Directors also increased by 2% from 1 January 2017.

The Remuneration Committee operates a Performance Share Plan ('PSP') based on the following principles:

- A normal maximum award of 100% of salary each year;
- A fixed 3 year performance period (with no re-setting); and
- A performance condition based on Earnings per share, Total Shareholder Return and sales levels.

No awards were made in 2016.

Details of the Remuneration Committee, advisers to the Committee and their fees

The Remuneration Committee currently comprises three independent Non-executive Directors and the Company Chairman. Details of the Directors who were members of the Committee during the year are disclosed on pages 24 and 25.

The Remuneration Committee appointed and used the services of FIT Remuneration Consultants LLP to advise on certain aspects of remuneration during 2016. The total fees charged for the year for Remuneration Committee advice was £14,000 and the Directors consider FIT Remuneration Consultants LLP to be independent of the Group and objective in their advice.

Statement of voting at the Annual General Meeting

At the AGM held on 10 May 2016, the Directors' Remuneration Report and Remuneration Policy received the following votes from shareholders.

	Remuneration Report		Remuneration Policy	
	Total number of votes	% votes cast	Total number of votes	% votes cast
For	**60,860,201**	99.93%	**60,702,093**	99.67%
Against	**42,167**	0.07%	**202,989**	0.33%
Total votes cast (for or against)	**60,902,368**	100.00%	**60,905,082**	100.00%
Votes withheld	**222,350**		**219,636**	
Total	**61,124,718**		**61,124,718**	

Remuneration policy

The following pages summarise the main elements of the remuneration packages of Executive Directors from the Company's Remuneration Policy. The full policy, which was approved at the 2016 AGM, is available under the Corporate Governance section of the Company website (www.macfarlanegroup.com).

Base salary (fixed pay)

Link to strategy	To pay a fair salary commensurate with the individual's role, responsibilities and experience and having regard to market rates for similar roles in comparable companies.
Operation	The Remuneration Committee reviews basic salaries annually with changes effective from 1 January. This review takes into account practices elsewhere in the Group.
Opportunity	There is no prescribed maximum salary or maximum rate of increase. The Committee will take into consideration the general increase for the broader employee population but on occasion may need to recognise changes in responsibility, development in the role or specific retention issues.

Benefits (fixed pay)

Link to strategy	To provide cost effective benefits to aid recruitment and retention of senior executives and to support the wellbeing of employees.
Operation	Benefits comprise, car allowance or company car, private medical insurance and permanent health insurance.
Opportunity	The benefits are not subject to a specific cap but represent a small element of total remuneration. Costs to provide these benefits are closely monitored.

Pension (fixed pay)

Link to strategy	To provide market competitive pension arrangements to aid recruitment and retention of senior executives.
Operation	The Group will pay a pension allowance or contribute to a pension scheme for all Executive Directors. The Group's legacy defined benefit plan has been closed to new members and the pensionable salary frozen in 2010.
Opportunity	Company contribution of up to 25% of base salary or equivalent cash allowance in lieu (inclusive of employer's national insurance contribution).

Annual incentives (variable pay)

Link to strategy	To incentivise performance over a 12 month period based on financial targets and individual performance objectives agreed by the Remuneration Committee.
Operation	The bonus is paid in cash based on the audited financial results and the Remuneration Committee's assessment of delivery against personal objectives. Any bonus award in respect of periods from 2015 is subject to penalty and clawback provisions covering material misstatement of Group results and is in force for 2 years following the award.
Opportunity	Maximum bonus potential capped at 100% of base salary but will remain at 50% for 2017.
Performance measure	The performance measures applied may be financial or non-financial and corporate, divisional or individual and in such proportions as the Committee considers appropriate. The annual bonus plan remains a discretionary arrangement and the Committee retains a standard power to apply its judgement to adjust the outcome of the annual bonus plan for any performance measure (from zero to any cap) should it consider that to be appropriate.

Long term incentive (variable pay)

Link to strategy	To incentivise delivery of strategic targets and sustained performance over the long-term.
Operation	Each year conditional awards over shares may be granted which can be earned subject to the delivery of performance goals. The Committee may set such performance conditions on PSP awards as it considers appropriate (whether financial or non-financial and whether corporate, divisional or individual). Performance conditions are for a fixed three-year period and there is no re-setting. Executive Directors are expected to build up a prescribed level of shareholding equivalent to 100% of base salary. If the prescribed shareholding has not been reached, Executive Directors will be expected to retain a proportion of the shares vesting under the Company's PSP until the guideline is met.
Opportunity	Any award is capped at 100% of base salary in normal circumstances (200% in exceptional circumstances).
Performance measure	Conditional awards will vest based on three-year performance against challenging financial and/or other targets set and assessed by the Committee in its discretion.

Corporate governance

The Company is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued in September 2014 ('the Code') by the Financial Reporting Council ('FRC'). The Company's compliance is set out in the narrative statement on pages 34 to 40 and for Directors' remuneration in the Report on Directors' Remuneration on pages 28 to 33.

Graeme Bissett
Chairman

Compliance

The Company complied with all Code provisions during 2016. The Company's auditor, KPMG LLP, is required to review whether the above statement reflects the Company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for its review by the Listing Rules and to report if it does not reflect such compliance.

The Board

The Board comprises the Chairman, three independent Non-executive Directors and two Executive Directors. The names of the Directors, together with their biographical details, illustrating their range of experience, are set out on pages 24 and 25. Details of Executive Directors' service contracts are given in the Remuneration policy statement on the Company's website www.macfarlanegroup.com and both service contracts have notice periods of one year.

The current Board structure is in compliance with the Code, requiring companies outside the FTSE 350 to have at least two independent Non-executive Directors. The Directors believe that the Board has an appropriate independent Non-executive Director complement with recent and relevant experience, which brings strong, independent judgement to the Board's deliberations.

Non-executive Directors contribute towards and challenge Group strategy as well as scrutinising performance in meeting agreed objectives and monitoring the reporting of performance. They satisfy themselves as to the integrity of the financial information and that the financial controls and systems of risk management are robust and defensible.

Non-executive Directors are given access to independent professional advice at the Group's expense, subject to certain limits and procedures, when it is deemed necessary in order for them to carry out their responsibilities. No such advice was sought during the year.

The Company has maintained Directors' and officers' liability insurance cover throughout the financial year. The Company made qualifying third party indemnity provisions for the benefit of Directors in 2009, and these remained in force throughout 2016 and to the time of this report.

The Board confirms that it has considered and authorised any conflicts or potential conflicts of interest in accordance with the Group's existing procedures.

Details of the Chairman's other commitments are included in his biography on page 24. The Board is satisfied that these do not interfere with the performance of his duties for the Group, which is based on a commitment of approximately 45 days per annum.

The Board considers its Non-executive Directors, Mike Arrowsmith, Stuart Paterson and Bob McLellan to be independent both in character and judgement. None of these three Directors:

- Has been an employee of the Group within the last five years;
- Has, or has had within the last three years, a material business relationship with the Group;
- Receives remuneration other than a Director's fee;
- Has close family ties with any of the Group's advisers, Directors or senior employees;
- Holds cross-directorships or has significant links with other Directors through involvement in other companies or bodies;
- Represents a significant shareholder; or
- Has served on the Board for more than nine years from the date of their first election.

The balance of the Board's skills and experience will be kept under review.

The roles of the Chairman and Chief Executive

The division of responsibilities between the Chairman and the Chief Executive is clearly defined and has been approved by the Board. The Chairman, Graeme Bissett, is responsible for running the Board, ensuring that all Directors receive sufficient and relevant information on financial, business and corporate issues prior to meetings to allow the Directors to bring independent judgement to bear on all issues. The Chairman facilitates the effective contribution of Non-executive Directors and ensures effective communication with shareholders. As Chief Executive, Peter Atkinson's responsibilities focus on managing the business and implementing the Group's strategy.

Senior Independent Director

The Board appointed Mike Arrowsmith as Senior Independent Director on 7 May 2013. Mike is the Director whom shareholders may contact if they feel their concerns are not being addressed and resolved through the existing mechanisms for investor communication.

Re-election of Directors

All Directors submit themselves for re-election by shareholders at least once in every three-year period. The Company is not a member of the FTSE 350 index of companies and is therefore not required to comply with provision B.7.1 of the Code, which requires all directors of companies in that index to be subject to annual re-election. At the 2017 AGM, Mike Arrowsmith and Peter Atkinson fall due to retire by rotation and, being eligible, offer themselves for re-election. Peter Atkinson's service contract and Mike Arrowsmith's letter of appointment will be available for shareholder review prior to the AGM on 9 May 2017.

Subject to the Company's Articles of Association, the Companies Act and satisfactory performance evaluation, Non-executive Directors are appointed for an initial period of three years. Before the third and sixth anniversary of the Non-executive Director's first appointment, the Chairman will discuss with the Director whether it is appropriate for a further three-year term to be served.

Company Secretary

Derek Quirk, who was appointed as Company Secretary on 1 March 2016, is responsible for advising the Board through the Chairman on all matters relating to corporate governance. Under the direction of the Chairman, the Company Secretary's responsibilities include ensuring good information flows within the Board, its committees and between executive management and Non-executive Directors. The Company Secretary also facilitates induction and assists with professional development for the Board. All Directors have access to the advice and services of the Company Secretary. The Articles of Association and the schedule of matters reserved for the Board provide that the appointment and removal of the Company Secretary is a matter for the Board as a whole.

Board procedures

The Group is controlled through its Board of Directors. The Board's main roles are to set the Group's strategic objectives, guide and support management in achieving these objectives, create value and safeguard the interests of shareholders within the appropriate legal and regulatory framework. The Board met seven times during 2016 and individual attendance at those and the Board Committee meetings is set out in the table on the following page. In 2016, three Board meetings were held at operational locations to allow the Board to meet management teams and further develop their understanding of the Group.

The Board has a formal schedule of matters reserved for its approval. The specific matters reserved to the Board include setting the Group's strategy and approving an annual budget, reviewing management performance, approving acquisitions, divestments and major capital expenditure, monitoring returns on investment, reviewing the Group's systems of internal control and risk management and consideration of significant financing matters. The Board has delegated to executive management responsibility for the development and recommendation of strategic plans for consideration by the Board, the implementation of the strategy and policies of the Group as determined by the Board, the delivery of the operating and financial plan, the approval of capital expenditure below Board authority levels and the development and implementation of risk management systems.

Regular reports and papers are circulated to the Directors in a timely manner in preparation for Board and Committee meetings. These papers are supplemented by information specifically requested by the Directors from time to time.

At each meeting, the Directors receive management accounts and reports from the Chief Executive and the Finance Director which, together with other papers, enables them to scrutinise the Group and management performance against agreed objectives.

Accountability

The Board is responsible for presenting a fair, balanced and understandable assessment of the Group's position and prospects. The Board considers that the Annual Report provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

After making the enquiries set out on pages 49 and 50, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for at least the next twelve months. For this

Corporate governance (continued)

Attendance by Directors at Board and Committee meetings

	Board	Audit Committee	Remuneration Committee	Nominations Committee
Graeme Bissett Chairman	7 (7)	3 (3)*	3 (3)	1 (1)
Peter Atkinson Chief Executive	7 (7)	–	–	–
John Love Finance Director	7 (7)	–	–	–
Mike Arrowsmith Senior Independent Director	7 (7)	3 (3)	3 (3)	1 (1)
Stuart Paterson Non-executive Director	7 (7)	3 (3)	3 (3)	1 (1)
Bob McLellan Non-executive Director	7 (7)	3 (3)	3 (3)	1 (1)

Figures in brackets indicate the maximum number of meetings in the period in which the individual was a Board or Committee member.
* indicates that a Director is attending but is not a member of the relevant Committee.

reason they continue to adopt the going concern basis in preparing the financial statements.

The Directors' Responsibilities Statement is set out on page 41.

Board and Committee meetings

The number of regular Board and Committee meetings attended by each member during 2016 is shown in the table above.

Where a Director cannot attend a Board or Committee meeting, his comments on the papers to be considered at that meeting are relayed in advance to the relevant Chairman.

Professional development

On appointment, Directors complete an induction programme designed to give them a thorough understanding of the Group and its activities. They receive information about the Group, the matters reserved for the Board, the terms of reference and membership of the Board Committees, and the latest financial information. This is supplemented with visits to key locations and meetings with and presentations from senior management.

Board performance evaluation

The Board has established a formal process, led by the Chairman, for the annual performance evaluation of the Board, its Committees and individual Directors. All Directors are made aware on appointment that their performance will be subject to regular evaluation.

The Board has completed a self-assessment questionnaire developed to take account of the areas identified in the FRC 'Guidance on Board Effectiveness'. This includes specific reference to the strategic objectives and performance of the Board and performance and processes for all Board Committees. The results have been collated by the Company Secretary and reviewed by the Board to identify any areas for improvement and to confirm objectives for the year ahead. The Chairman then holds individual meetings with each Director to review performance and set individual objectives.

The Chairman meets periodically with the Non-executive Directors without the Executive Directors present. Led by the Senior Independent Director, the three Non-executive Directors meet annually to conduct a performance evaluation of the Chairman.

Relationships with shareholders

The Group maintains a corporate website (www.macfarlanegroup.com) containing a wide range of information of interest to institutional and private investors. Detailed reviews of the performance and financial position are included in the Strategic Report on pages 2 to 23 of this report. The Board uses this together with the Chairman's Statement on pages 4 and 5, and the remainder of the Report of the Directors on pages 26 and 27 to present its assessment of the Company's position and prospects.

The Chairman seeks to maintain a regular dialogue with shareholders and gives feedback to the Board on issues raised. The Group has frequent discussions with institutional shareholders, including meetings led by the Chief Executive and the Finance Director, following the preliminary announcement of the annual financial results in February and the announcement of interim results in August. The Group also responds to individual requests for discussions from shareholders.

The Board receives feedback on shareholder meetings including broker feedback for the meetings scheduled around the preliminary announcement and interim results. The Senior Independent Director is available to meet with shareholders if they have concerns with contact through the normal channels of Chairman, Chief Executive or Finance Director.

All Directors attend the AGM and shareholders are invited to ask questions during the meeting and to meet Directors after the formal proceedings have ended. All shareholders have an opportunity to raise questions with members of the Board on matters relating to the Group's operations and performance at the meeting. Details of the resolutions to be proposed at the AGM can be found in the Notice of Meeting accompanying the Annual Report and Accounts. In line with the requirements of the Code, the results of proxy votes are disclosed at the AGM and made available on the Group website and the Notice of Meeting is sent out more than 20 days in advance of the meeting.

Nominations Committee

The Nominations Committee membership was as follows:

Graeme Bissett (Chairman)
Mike Arrowsmith
Stuart Paterson
Bob McLellan

The Nominations Committee met once during 2016 and its terms of reference are available on the Group website (www.macfarlanegroup.com).

The principal work undertaken by the Nominations Committee in 2016 was to consider and recommend that the Company propose for re-election any Directors falling due for re-appointment at the AGM.

The Committee's responsibilities include reviewing the structure, size and composition of the Board and giving full consideration to succession planning for Directors and other senior executives. The Nominations Committee will continue to consider the mix of skills and experience that the Board requires and seek the appointment of Directors to meet its assessment of what is required to ensure that the Board is effective in discharging its responsibilities.

In addition the Committee met during 2016 to consider proposing Bob McLellan and John Love for election at the AGM on 10 May 2016. Both were recommended for election and this was approved by shareholders at the 2016 AGM. No Director is involved in any decisions regarding his own appointment or re-appointment.

Following a Nominations Committee held on 21 February 2017 the Committee proposed Peter Atkinson and Mike Arrowsmith for re-election at the AGM on 9 May 2017.

Remuneration Committee

The Remuneration Committee membership was as follows:

Bob McLellan (Chairman)
Graeme Bissett
Mike Arrowsmith
Stuart Paterson

None of the members of the Remuneration Committee during 2016 has any personal financial interests, other than as a shareholder, in the matters to be decided, conflicts of interests arising from cross-directorships or any day-to-day involvement in running the business.

The Remuneration Committee met three times during 2016 and its terms of reference are available on the Group website (www.macfarlanegroup.com).

The principal work undertaken by the Remuneration Committee in 2016 was:

(a) To review performance against 2016 financial and personal objectives and to conclude on the appropriate performance related reward for senior executives including the Executive Directors;
(b) To approve the financial and personal objectives for 2016 in relation to the performance related bonus;
(c) To consider the use of share-based incentives, either using the Long Term Incentive Plan or within a SAYE scheme; and
(d) To approve the Report on Directors' Remuneration.

The work carried out by the Remuneration Committee is described within the Report on Directors' Remuneration, which is set out on pages 20 to 24.

Audit Committee

Throughout 2016 the Audit Committee comprised:

Stuart Paterson (Chairman)
Mike Arrowsmith
Bob McLellan

Stuart Paterson was appointed as Chairman of the Audit Committee on 1 January 2013 and has both recent and relevant financial experience. The remaining Committee members, Mike Arrowsmith and Bob McLellan have a wide range of commercial experience, as evidenced in their biographical details on page 24. The Company Chairman attends meetings to give the Committee the benefit of his relevant experience but he is no longer a member of that Committee with effect from 1 January 2013.

The Committee's terms of reference are displayed on the Group website (www.macfarlanegroup.com) and its principal oversight responsibilities cover the following five areas:

- **Internal control and risk management**
  The Committee reviews annually the Group's system of risk management and internal control and processes for evaluating and monitoring the risks facing the Group.

- **Internal audit**
  The Committee reviews the effectiveness of the internal audit function and its terms of reference on an annual basis and recommends to the Board any changes required as a result of the review. Reports from internal audit are considered at each meeting and as part of its deliberations, the Committee will actively engage in selecting areas to be audited.

Corporate governance (continued)

Audit Committee (continued)

- **Viability statement**
  The Board has carried out a robust assessment of the principal risks facing the Company and how these risks affect the prospects of the Company. Pages 16 and 17 give information on these risks and uncertainties and the mitigating actions being taken to address them. The viability statement set out on pages 16 and 17 includes scenario testing of the key risks in order to determine their potential impact on the prospects of the Company. The overall responsibility for the systems of internal control and for reviewing their effectiveness rests with the Board. The review of the effectiveness of the systems of internal control is carried out by the Audit Committee as set out above.

- **External audit**
  The Committee is responsible for monitoring the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, re-appointment and remuneration of the external auditor. It is responsible for ensuring that an appropriate relationship between the Group and the external auditor is maintained, including formal consideration of the independence of the auditor as well as considering the framework used for the supply of non-audit services by the auditor and reviewing non-audit services and fees.

- **Financial reporting**
  Under its terms of reference, the Audit Committee monitors the integrity of the Group's financial statements and any formal announcements relating to the Group's performance. Further details are set out on the following pages.

The Audit Committee met three times during 2016 and its agenda is linked to events in the Group's financial calendar. The Committee meets privately with the external auditor, with the internal auditors and Executive Directors invited to attend meetings as required. In 2016 the Audit Committee discharged its responsibilities by:

- Reviewing the Group's draft financial statements and interim results statement prior to Board approval and reviewing the external auditor's reports thereon;
- Debating the continuing appropriateness of the Group's accounting policies;
- Monitoring compliance with International Financial Reporting Standards;
- Challenging the output from the Group-wide process used to identify, evaluate and mitigate risks;
- Reviewing the effectiveness of the Group's internal controls and disclosures made in the annual report and financial statements on this matter;
- Agreeing a programme of work for the Company's internal audit function taking into account those risks identified;
- Discussing reports from the Head of Internal Audit on the work undertaken by Internal Audit and management responses to proposals made in the audit reports issued by the function during the year, ensuring that these responses are actioned and completed on a timely basis;
- Agreeing the external auditor's plan for the audit of the Group accounts which included confirmations of auditor independence and approval of the engagement letter; and
- Reviewing and approving the audit fee and keeping the level of non-audit fees paid to the Group's external auditor under review.

2016 Financial statements

Certain accounting policies have been identified as requiring key accounting judgements or involving particularly complex or subjective estimates or assumptions, which in turn have a significant effect on the amounts recognised in the financial statements. The Audit Committee receives a report from the Finance Director, in respect of each reported set of results, summarising the principal judgements taken by executive management. The Committee discusses and challenges these judgements and considers the report in conjunction with the results of the external audit process. The Committee then makes a recommendation to the Board on the suitability of the policies and judgements supporting the reported results.

For the 2016 financial statements, the Committee considers the two most significant areas of judgement to be:

Pension scheme deficit

A net liability is recorded at each reporting date equivalent to the deficit on the Group's defined benefit pension scheme. This liability is determined in conjunction with advice from the Pension Scheme actuary and the Group's actuarial advisers and can fluctuate significantly based on a number of assumptions, some of which are linked to market-related factors outwith the control of management. The main actuarial assumptions that can impact the deficit are set out in note 24 to the financial statements. Investments are valued at bid price and confirmed by the scheme's Investment adviser.

The Audit Committee debated the assumptions being used to determine the liabilities in accordance with guidance from a number of actuarial firms and has satisfied itself that the assumptions used fall within an acceptable range taking into account the duration of liabilities in the Macfarlane Group defined benefit pension scheme.

The level of deficit calculated by the Scheme actuary and the related disclosures are based on these assumptions and the components of the movement in the pension scheme deficit in the year have all been explained to the Committee's satisfaction. In addition the sensitivities of movements in the underlying assumptions are clearly set out in note 24. Accordingly the Committee is comfortable with the reporting of the pension scheme deficit.

Valuation of trade receivables

Trade receivables recorded in the Group's balance sheet comprise a large number of individual balances. The Group reviews all trade receivables and provides against potentially irrecoverable items throughout the year. The Group's executive management then reviews local judgements. Whilst every attempt is made to ensure that the allowance for doubtful trade receivables is as accurate as possible, there remains a risk that the allowance may not match the level of debt, which ultimately proves to be uncollectible. At 31 December 2016, the Group retained an allowance for doubtful trade receivables of £326,000, compared to £386,000 in 2015. Further details are set out in note 13.

The Audit Committee has access to details of individual receivables in excess of £50,000 during the year. The Committee reviews the analysis of the extent to which year-end balances have been settled in 2017 to date, paying particular attention to receivables outwith terms, comparing this with similar analyses produced at previous reporting dates. This is then considered against the level of allowance for doubtful trade receivables and based on this analysis, the Committee is of the view that the level of provision and the disclosures of items beyond terms was appropriate.

Consideration of other matters

The Committee debates a number of other areas as a matter of normal practice at each reporting period, but does not consider these matters to be of such significance as those outlined previously. For the 2016 financial statements, other areas included:

- The acquisition of subsidiaries is accounted for under the purchase method. The acquired businesses are measured at the date of acquisition as the aggregate fair value of assets, liabilities and contingent liabilities. The excess of the cost of acquisition over the fair value of the identifiable assets is represented as goodwill. The Committee reviews this process for each acquisition undertaken and discusses the methodology and assumptions used with management. The Committee concluded that it was satisfied with the basis of accounting in this area and the resulting measurements;
- Goodwill is allocated to cash generating units (CGU's) expected to benefit from the synergies of the business combination, for the purpose of impairment testing. The carrying value of goodwill for each CGU is considered annually. The Committee reviews and discusses management's approach in this area, including not only the impairment testing but also the related sensitivity analysis. The Committee was satisfied with the assumptions and judgements applied and concluded that there was no impairment to goodwill;
- The level of and basis for inventory provisions at 31 December 2016; and
- A review of the viability statement including the disclosure of the principal terms of the Group's banking facilities.

For all of these other matters the Audit Committee is satisfied with the approach taken.

The Audit Committee has reviewed the contents of this year's annual report and accounts and has advised the Board that, in its view, the report is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

The Audit Committee also monitors the Group's arrangements by which staff may in confidence raise concerns about possible improprieties in matters of financial reporting and other areas including an external whistle-blowing service to take calls from employees. Details are included on the Group website (www.macfarlanegroup.com). All concerns will continue to be investigated at the earliest opportunity and the employee's anonymity is preserved wherever possible.

Relationship with external audit

The Audit Committee is responsible for the development, implementation and monitoring of the Group's position on external audit. The Committee's terms of reference assign oversight responsibility for monitoring the independence, objectivity and compliance with ethical and regulatory requirements to the Audit Committee, and day-to-day responsibility to the Finance Director. The Audit Committee has ensured that the Board and external auditor have safeguards in place to prevent auditor's independence and objectivity being compromised. The external auditor also reports to the Committee on the actions that it has taken to comply with professional and regulatory requirements and current best practice in order to maintain independence.

Corporate governance (continued)

The Committee has considered the likelihood of a withdrawal of the auditor from the market and noted that there are no contractual obligations to restrict the choice of external auditor. In accordance with best practice, the audit partner from external auditor rotates off the audit engagement every 5 years. A new audit partner is in place for the 2016 audit.

The Audit Committee monitors non-audit services provided to the Group by its external auditor. The Committee recognises that there will be certain non-audit work which the external auditor is best placed to undertake. Similarly there will be non-audit work in relation to the design of controls and systems that the external auditor should not undertake.

The Committee's policy is to keep all services provided by the external auditor under review to ensure the independence and objectivity of the external auditor, taking account of relevant professional and regulatory requirements. All non-audit work over a certain level to be undertaken by the external auditor has to be approved by the Audit Committee. Details of amounts paid to KPMG LLP during 2016 for audit and other services are set out in note 2 to the financial statements.

The Committee Chairman will be available to answer questions on any aspect of the Committee's work at the AGM.

Risk management and internal control

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. It is management's role to implement the Board's policies on risk and control through the design and operation of appropriate internal control systems. Such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives and by their nature can only provide reasonable and not absolute assurance against material mis-statement or loss.

The Board confirms that an ongoing process for identifying, evaluating and managing the significant risks faced by the Group was in place in compliance with the guidance of the Turnbull Review Group. The process has been in place throughout the year under review and has continued to the date of approval of the annual report and financial statements.

The Board regularly reviews the Group's system of internal control. The Board's monitoring covers all controls including financial, operational and compliance controls and risk management.

The key elements of the internal control process are:

- Formal Board reporting on a monthly basis by the Chief Executive and the Finance Director;
- Formal Board approval of the annual budget;
- Since 2009, the internal audit function has been sourced in-house. Certain parts of the internal audit plan may be outsourced when it is considered that specific expertise is required. The Committee challenges and agrees the annual plan proposed by Group management, receives reports on all internal audit issues raised and an update from the Head of Internal Audit on a six-monthly basis;
- Monthly and annual financial control checklists submitted by each business unit;
- Discussion by the Committee of the external auditor's conclusions in its annual audit and interim review; and
- A robust risk assessment process as set out below.

A specific area of focus for Internal Audit in 2016 was to review cyber security processes and controls in the Packaging Distribution business. In addition to standard follow up processes, the Committee requested progress reports to emphasise the importance of having robust cyber security measures in place as part of the corporate governance framework, but also to ensure that employees, customers and suppliers are protected from the impact of cyber security breaches.

During the course of its review of the system of internal control, the Board has not identified nor been advised of any failings or weaknesses which it has determined to be significant. No significant corrective actions are outstanding.

Each business's risk register is kept under review during regular review meetings in each business. The Board considers the risk register every six months to maintain an overview of risks facing the Group and ensure that management have identified and implemented appropriate controls to address these risks, which are acceptable to the Board. The risk register is taken into account in setting the internal audit programme each year.

The Directors have continued to review the effectiveness of the Group's system of financial and non-financial controls.

Statement of Directors' responsibilities in respect of the Annual Report and the financial statements

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework.

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 of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company 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;
- For the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- For the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

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

Responsibility statement of the Directors in respect of the annual financial report

We confirm that to the best of our 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 Strategic Review, which is incorporated into the Directors' Report, includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

On behalf of the Board

Peter D. Atkinson	**John Love**
Chief Executive	Finance Director
23 February 2017	23 February 2017

Independent auditor's report to the members of Macfarlane Group PLC only

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of Macfarlane Group PLC for the year ended 31 December 2016 set out on pages 45 to 88. 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 2016 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 as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with UK Accounting Standards, including FRS 101 *Reduced Disclosure Framework*; 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.

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement, in decreasing order of audit significance, that had the greatest effect on our audit were as follows (unchanged from 2015):

Valuation of retirement benefit deficit £14.5 million (2015 – £11.5 million) Risk vs 2015 ↑

Refer to page 38 (Audit Committee statement), page 51 (accounting policy) and note 24 financial disclosures).

- **The risk** – Significant assumptions and estimates are made in valuing the Group's post-retirement defined benefit scheme and small changes in assumptions and estimates used to value the Group's net pension deficit would have a significant effect on the results and financial position of the Group. We have assessed a higher risk over the balance in 2016 due to the sensitivity of the scheme to movements in discount rates which have altered substantially from the prior year.
- **Our response** – Our audit procedures included, with support of our own internal actuarial specialists, challenging the appropriateness of key assumptions used in deriving the value of the scheme's liabilities, being the discount rate, life expectancy and inflation, by comparing these with our internal actuarial indicators. We performed an assessment of the independence and competence of the external actuaries engaged by the Group to produce the actuarial valuation of the scheme liabilities. We also considered the adequacy of the Group's disclosures in respect of the sensitivity of the deficit to these assumptions.

Carrying value of trade receivables £42.2 million (2015 – £37.1 million) Risk vs 2015 ⇔

Refer to page 39 (Audit Committee statement), page 52 (accounting policy) and note 13 (financial disclosures).

- **The risk** – The Group has significant trade receivables, comprised of a high volume of individual balances, of which a number are material to the financial statements. At year end, £11.8 million are past due, representing 27.8% of the balance (2015 – 29.9%).These factors result in a risk over the recoverability of the Group's trade receivables.
- **Our response** – Our audit procedures included testing the design and operating effectiveness of a selection of the Group's controls over the receivables collection processes, including the Group's credit control processes over aged receivables and customer credit approvals. Tests of effectiveness were performed by reperforming a sample selected on the basis of the frequency of control operation and were designed to verify that appropriate procedures were followed in each instance. For a sample of customer balances where no post-year end payment evidence was available we tested the adequacy of the Group's provisions with reference to the profile of aged debts at the balance sheet date compared with equivalent data observed subsequent to and at prior year ends.

3. Our application of materiality and an overview of the scope of our audit

The materiality for the Group financial statements as a whole was set at £450,000 (2015 – £450,000), determined with reference to a benchmark of Group profit before taxation, of £7.8 million, of which it represents 5.8% (2015 – 6.6%).

We report to the Audit Committee any corrected and uncorrected identified misstatements exceeding £22,000, in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group audit team performed the audit of the Group as if it was a single aggregated set of financial information, with the exception of two insignificant components. The audit was performed at the materiality level set out above.

The graphs below illustrate comparative materiality levels and audit scope coverage.

4. 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 Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

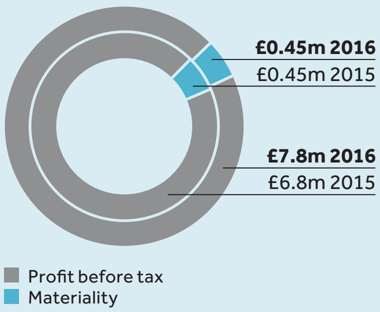
- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

5. We have nothing to report on the disclosures of principal risks

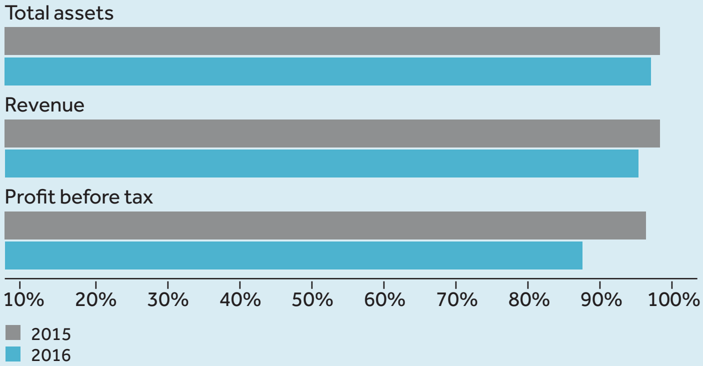
Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Directors' Viability Statement on pages 16 and 17, concerning the principal risks, their management, and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the 3 years to 2019; or
- the disclosures in note (a) of the Summary of Accounting Policies set out on pages 49 and 50 concerning the use of the going concern basis of accounting.

Materiality



Group audit scope coverage



Independent auditor's report to the members of Macfarlane Group PLC only (continued)

6. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

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

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the Corporate Governance Statement describing the work of the Group Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

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 pages 16 and 17, in relation to going concern and longer-term viability;
- the part of the Corporate Governance Statement on pages 34 to 40 relating to the Company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 41, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. 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. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Hugh Harvie (Senior Statutory Auditor)
for and on behalf of KPMG LLP,
Statutory Auditor
Chartered Accountants
319 St Vincent Street
Glasgow G2 5AS

23 February 2017

Consolidated income statement

For the year ended 31 December 2016

	Note	2016 £000	2015 £000
Continuing operations			
Revenue	1	**179,772**	169,132
Cost of sales		**(124,059)**	(115,911)
Gross profit		**55,713**	53,221
Distribution costs		**(7,622)**	(7,587)
Administrative expenses		**(39,379)**	(37,932)
Operating profit	1, 2	**8,712**	7,702
Net finance costs	4	**(901)**	(935)
Profit before tax		**7,811**	6,767
Tax	5	**(1,761)**	(1,317)
Profit for the year	6, 20	**6,050**	5,450
Earnings per share	8		
Basic		**4.67p**	4.37p
Diluted		**4.64p**	4.35p

The accompanying notes are an integral part of this consolidated income statement.

Consolidated statement of comprehensive income

For the year ended 31 December 2016

	Note	2016 £000	2015 £000
Items that may be reclassified to profit or loss			
Foreign currency translation differences – foreign operations	20	**195**	(62)
Items that will not be reclassified to profit or loss			
Remeasurement of pension scheme liability	24	**(5,552)**	111
Tax recognised in other comprehensive income			
Tax on remeasurement of pension scheme liability	18	**1,000**	(22)
Long-term corporation tax rate change	18	**(146)**	(229)
Other comprehensive expense for the year, net of tax		**(4,503)**	(202)
Profit for the year		**6,050**	5,450
Total comprehensive income for the year		**1,547**	5,248

The accompanying notes are an integral part of this consolidated statement of comprehensive income.

Consolidated statement of changes in equity

For the year ended 31 December 2016

	Note	Share capital £000	Share premium £000	Revaluation reserve £000	Translation reserve £000	Retained earnings £000	Total £000
At 1 January 2015		31,153	1,018	70	121	(2,116)	30,246
Comprehensive income							
Profit for the year		–	–	–	–	5,450	5,450
Foreign currency translation difference – foreign operations	20	–	–	–	(62)	–	(62)
Remeasurement of pension scheme liability	24	–	–	–	–	111	111
Tax on remeasurement of pension scheme liability	18	–	–	–	–	(22)	(22)
Long-term corporation tax rate change	18	–	–	–	–	(229)	(229)
Total comprehensive income		–	–	–	62	5,310	5,248
Transactions with shareholders							
Dividends	7	–	–	–	–	(2,094)	(2,094)
Share-based payments	25	–	–	–	–	72	72
Total transactions with shareholders		–	–	–	–	(2,022)	(2,022)
At 31 December 2015		**31,153**	**1,018**	**70**	**59**	**1,172**	**33,472**
Comprehensive income							
Profit for the year		**–**	**–**	**–**	**–**	**6,050**	**6,050**
Foreign currency translation difference – foreign operations	20	**–**	**–**	**–**	**195**	**–**	**195**
Remeasurement of pension scheme liability	24	**–**	**–**	**–**	**–**	**(5,552)**	**(5,552)**
Tax on remeasurement of pension scheme liability	18	**–**	**–**	**–**	**–**	**1,000**	**1,000**
Long-term corporation tax rate change	18	**–**	**–**	**–**	**–**	**(146)**	**(146)**
Total comprehensive income		**–**	**–**	**–**	**195**	**1,352**	**1,547**
Transactions with shareholders							
Dividends	7	**–**	**–**	**–**	**–**	**(2,358)**	**(2,358)**
Share-based payments	25	**–**	**–**	**–**	**–**	**108**	**108**
Issue of share capital	19,20	**2,931**	**3,623**	**–**	**–**	**–**	**6,554**
Total transactions with shareholders		**2,931**	**3,623**	**–**	**–**	**(2,250)**	**4,304**
At 31 December 2016		**34,084**	**4,641**	**70**	**254**	**274**	**39,323**

The accompanying notes are an integral part of this consolidated statement of changes in equity.

Consolidated balance sheet

At 31 December 2016

	Note	2016 £000	2015 £000
Assets			
Non-current assets			
Goodwill and other intangible assets	9	**44,002**	36,181
Property, plant and equipment	10	**7,770**	7,691
Trade and other receivables	13	**425**	559
Deferred tax assets	18	**2,878**	2,499
Total non-current assets		**55,075**	46,930
Current assets			
Inventories	12	**12,986**	10,559
Trade and other receivables	13	**48,572**	43,238
Cash and cash equivalents	14	**1,930**	1,407
Total current assets		**63,488**	55,204
Total assets	1	**118,563**	102,134
Liabilities			
Current liabilities			
Trade and other payables	15	**43,202**	41,297
Current tax liabilities		**1,020**	654
Finance lease liabilities	17	**395**	388
Bank borrowings	14	**17,206**	13,039
Total current liabilities		**61,823**	55,378
Net current assets/(liabilities)		**1,665**	(174)
Non-current liabilities			
Retirement benefit obligations	24	**14,537**	11,518
Deferred tax liabilities	18	**1,697**	988
Trade and other payables	15	**781**	40
Finance lease liabilities	17	**402**	738
Total non-current liabilities		**17,417**	13,284
Total liabilities	1	**79,240**	68,662
Net assets	1	**39,323**	33,472
Equity			
Share capital	19	**34,084**	31,153
Share premium	20	**4,641**	1,018
Revaluation reserve	20	**70**	70
Translation reserve	20	**254**	59
Retained earnings	20	**274**	1,172
Total equity		**39,323**	33,472

The accompanying notes are an integral part of this consolidated balance sheet.

The financial statements of Macfarlane Group PLC, company registration number SC004221, were approved by the Board of Directors on 23 February 2017 and signed on its behalf by

Peter D. Atkinson
Chief Executive

John Love
Finance Director

Consolidated cash flow statement

For the year ended 31 December 2016

	Note	2016 £000	2015 £000
Net cash inflow from operating activities	21	**3,294**	5,368
Investing activities			
Acquisition of subsidiary undertakings	22	**(8,718)**	(3,941)
Proceeds from disposal of property, plant and equipment		**57**	263
Acquisition of property, plant and equipment		**(1,144)**	(809)
Net cash used in investing activities		**(9,805)**	(4,487)
Financing activities			
Dividends paid	7	**(2,358)**	(2,094)
Proceeds from issue of share capital (net of issue expenses)		**5,554**	–
Drawdown on bank borrowing facility		**4,167**	1,690
Repayment of finance lease liabilities		**(329)**	(320)
Net cash generated by/(used in) financing activities		**7,034**	(724)
Net increase in cash and cash equivalents		**523**	157
Cash and cash equivalents at beginning of year		**1,407**	1,250
Cash and cash equivalents at end of year	21	**1,930**	1,407

There is no material impact of foreign exchange rate differences on the cash and cash equivalents balance at the end of the current or preceding financial year.

The accompanying notes are an integral part of this consolidated cash flow statement.

Accounting policies

For the year ended 31 December 2016

Summary of accounting policies

Macfarlane Group PLC is a public company listed on the London Stock Exchange, incorporated and domiciled in the UK.

In preparing the Group financial statements in conformity with IFRSs, the Directors are required to make judgements, estimates and assumptions that impact the carrying amounts of revenues, expenses, assets and liabilities that are not readily apparent from other sources. The judgements, estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

Judgements, assumptions and estimation uncertainties

In preparing these consolidated financial statements, management has made judgements, estimates and assumptions, which affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from the amounts estimated.

Estimates and underlying assumptions are reviewed on an ongoing basis and revisions to estimates recognised prospectively.

Information about judgements, assumptions and estimation uncertainties made in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements and therefore have the most significant risk of resulting in a material change is included in the following notes:

Subject	Note	Area of assumptions and estimation uncertainties
Retirement Benefit Obligations	24	The valuation of the pension deficit is affected by small movements in key actuarial assumptions
Trade and Other Receivables	13	The provision for doubtful receivables is based on judgemental estimates over the recoverable amounts

The following accounting policies have been applied consistently for items which are considered to be material in relation to the financial statements.

(a) Basis of accounting

The 2016 financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and therefore the Group financial statements comply with Article 4 of the EU IAS Regulation. These consolidated financial statements are presented in Sterling, which is the Company's functional currency. All amounts have been rounded to the nearest thousand, unless otherwise indicated.

The following adopted IFRSs have been issued but have not been applied by the Group in these financial statements:

IFRS 9	Financial Instruments – effective for the year ending 31 December 2018
IFRS 15	Revenue from Contracts with Customers – effective for the year ending 31 December 2018
IFRS 16	Leases – effective for the year ending 31 December 2019

The Directors do not expect that the adoption of IFRS 9 will have a significant impact on the financial statements of the Group in future periods.

For IFRS 15 an impact assessment is being undertaken but there is unlikely to be a significant impact on the financial statements of the Group in future periods.

For IFRS 16 an initial impact assessment is being undertaken and whilst this standard is likely to have a material impact on the Group's balance sheet and income statement following adoption in 2019, the Directors will comment further in due course.

The financial statements have been prepared on the historical cost basis. The revaluation reserve relates to a period before transition to IFRS.

Going concern

The Directors, in their consideration of going concern, have reviewed the Group's future cash flow forecasts and profit projections, which they believe are based on a prudent assessment of the market and past experience. The Group's business activities, together with the factors likely to affect its future development, performance and financial position are set out in the Strategic Report on pages 2 to 23.

The Group's principal financial risks in the medium term relate to liquidity and credit risk. Liquidity risk is managed by ensuring that the Group's day-to-day working capital requirements are met by having access to banking facilities with suitable terms and conditions to accommodate the requirements of the Group's operations. Credit risk is managed by applying considerable rigour in managing the Group's trade receivables. The Directors believe that the Group is adequately placed to manage its financial risks effectively, despite any economic uncertainty.

Accounting policies (continued)

For the year ended 31 December 2016

Going concern (continued)

The Group has a committed borrowing facility of £25.0 million with Lloyds Banking Group PLC, in place until June 2019, with an additional option to increase it further to £30.0 million. The facility bears interest at normal commercial rates and carries standard financial covenants in relation to interest cover and levels of headroom over trade receivables.

The Directors are of the opinion that the Group's cash flow forecasts and profit projections, which they believe are based on a prudent assessment of the market and past experience taking account of reasonably possible changes in trading performance given current market and economic conditions, show that the Group should be able to operate within its current facility and comply with its banking covenants.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for at least the next twelve months. For this reason they continue to adopt the going concern basis in preparing the financial statements.

(b) Basis of consolidation

The consolidated income statement and the consolidated balance sheet include the financial statements of the parent company and its subsidiaries, all of which are wholly-owned, to the end of the financial year. The Group does not have any associates or other joint arrangements as defined by IFRS 10.

Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing control, the Group takes into consideration potential voting rights. The acquisition date is the date on which control is transferred to the acquirer. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests even if doing so causes the non-controlling interests to have a deficit balance.

On acquisition, the assets and liabilities of a subsidiary are measured at their fair values at the effective date of acquisition, defined as the date control is acquired. Any excess of the cost of acquisition over the fair values of the separately identifiable net assets is recognised as goodwill.

The results of subsidiaries acquired or disposed of during the period are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal. The consolidated gain or loss on disposal of a subsidiary is the difference between the net proceeds of sale and the Group's share of the subsidiary's net assets together with the carrying value of any related goodwill at the effective date of disposal.

Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated. Unrealised gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(c) Goodwill and other intangible assets

Goodwill arising in a business combination is recognised as an asset and represents the excess of the cost of acquisition over the net fair values of the identifiable assets and liabilities of the acquired business or subsidiary at the effective date of acquisition.

Goodwill is allocated to cash generating units ('CGUs') expected to benefit from the synergies of the combination, for the purpose of impairment testing. The carrying value of goodwill for each CGU is considered annually and also reviewed where management has reason to believe that a change in circumstances may give rise to any impairment.

Other intangible assets comprise separately identifiable intangible assets recognised on the acquisitions of businesses or subsidiary companies. They are recorded at fair value on acquisition less any amortisation and subsequent impairment. These are primarily brand values, which are calculated on the Relief from Royalty method, and customer relationship values, which are calculated on the excess earnings method based on the net anticipated earnings stream. Brand values are amortised on a straight-line basis over up to five years and customer relationships are amortised on a straight-line basis over ten years.

(d) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods provided to third parties in the normal course of business, net of discounts, VAT and other sales related taxes. Revenue from the manufacture and distribution of packaging materials and labels is recognised when the Group has transferred the significant risks and rewards of ownership of the goods to the customer, the amount of revenue and the costs related thereto can be measured reliably and it is probable that the economic benefits of the transaction will flow to the Group.

(e) Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as tangible assets of the Group at their fair value as determined at the inception of the lease. Depreciation is provided in accordance with the Group's accounting policy for the class of tangible asset concerned. Interest costs are charged over the lease term and future obligations, comprising the corresponding liability to the lessor, are included in the balance sheet as finance lease liabilities.

Rentals payable under operating leases are charged to the consolidated income statement on a straight-line basis over the term of the relevant lease. Incentives to enter into an operating lease are initially recorded as a liability and then treated as a reduction in the rental expense on a straight-line basis over the lease term.

(f) Foreign currencies

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the consolidated income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to the Group's presentational currency, Sterling, at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated at an average rate for the year where this rate approximates to the foreign exchange rates ruling at the dates of the transactions. Exchange differences arising from this translation of foreign operations are reported as an item of other comprehensive income and accumulated in the translation reserve.

(g) Retirement benefit costs

Defined contribution schemes

A defined contribution plan is a post-employment benefit plan under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the consolidated income statement in the periods during which services are rendered by employees.

Defined benefit schemes

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net retirement benefit obligation in respect of its defined benefit pension plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods. These benefits are then discounted to determine the present value, and the fair value of any plan investments, at bid price, are deducted. The Group determines the net interest on the net retirement benefit obligation for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the year.

The discount rate is the yield at the reporting date on bonds that have a credit rating of at least AA that have maturity dates approximating to the average duration of the Group's retirement benefit obligations and that are denominated in the currency in which the benefits are expected to be paid.

Remeasurements arising from defined benefit plans comprise actuarial gains and losses, returns on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest). Remeasurements are recognised in the statement of other comprehensive income and all other expenses related to defined benefit plans charged in staff costs in the consolidated income statement.

When the benefits of a plan are changed, or when a plan is curtailed, the portion of the changed benefit related to past service by employees, or the gain or loss on curtailment, is recognised immediately in the consolidated income statement when the plan amendment or curtailment occurs.

The calculation of the retirement benefit obligations is performed by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Group, the recognised asset is limited to the present value of benefits available in the form of any future refunds from the plan or reductions in future contributions and takes into account the adverse effect of the present value of any minimum funding requirements.

The Group operates a Group-wide defined benefit pension plan. The net defined benefit cost of the plan is apportioned to participating entities on the basis of the employment history of scheme members, who are allocated to the relevant subsidiary company, with any remaining unallocated members being charged to the parent company.

Accounting policies (continued)

For the year ended 31 December 2016

(h) Taxation

The tax expense represents the sum of the current tax payable and deferred tax.

Current tax is payable based on the taxable profit for the year. Taxable profit differs from profit before tax as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The current tax liability is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date and any adjustments in respect of prior years.

Deferred tax balances represent the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax assets and liabilities are not discounted.

The carrying value of deferred tax 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 to allow all or part of the asset to be recovered.

Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been substantively enacted at the balance sheet date. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited in other comprehensive income, in which case the deferred tax is also recorded in the consolidated statement of comprehensive income.

(i) Property, plant and equipment

Property, plant and equipment are stated at cost. Assets revalued before the date of transition to IFRS have been recorded at deemed cost.

No depreciation is provided on land. Depreciation is recognised so as to write off the cost of the tangible assets, less their estimated residual values, by equal annual instalments over their estimated useful lives. The rates of depreciation use the straight-line method and vary between 2% and 5% per annum on buildings and 7% and 33% per annum on plant and equipment. Rates of depreciation are reviewed annually to ensure they remain relevant and residual values are reviewed to ensure they remain appropriate once in each calendar year.

The gain or loss arising on the disposal or scrapping of an asset is determined as the difference between the sales proceeds and the carrying value of the asset and is recognised in the consolidated income statement.

(j) Inventories

Inventories are consistently stated at the lower of cost and net realisable value.

Cost represents average cost and is stated less provisions required for obsolescence. In the case of work in progress and finished goods, cost comprises direct materials, direct labour costs and attributable overheads that have been incurred in bringing the inventories to their present location and condition. Net realisable value is based on the estimated selling price, less any further costs expected to be incurred to completion and disposal.

(k) Financial instruments

Financial assets and financial liabilities are recognised in the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Financial assets categorised as investments, comprise investments in debt and equity securities and are initially recognised at fair value with any subsequent gains or losses recognised in the consolidated income statement.

Other financial assets comprise trade and other receivables that have fixed or determinable recoveries and are classified as trade and other receivables. The classification takes account of the nature and purpose of the financial assets and is determined on initial recognition. Trade and other receivables are measured at amortised cost less impairment.

Indicators are assessed for the **impairment of financial assets** at each balance sheet date. Financial assets are impaired when there is objective evidence that as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows have been impacted. For trade receivables the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying value of the allowance account are recognised in the consolidated income statement.

Cash and cash equivalents comprise cash on hand and on demand deposits, readily convertible to a known amount of cash and are subject to insignificant risk of changes in value.

Financial liabilities and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements.

Financial liabilities comprise solely other financial liabilities under the terms of IFRS 7. Financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. They are subsequently measured at amortised cost, with interest expense measured on an effective yield basis.

Equity instruments are any contracts evidencing a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments were not used in the current or preceding financial year.

(l) Provisions

The Group has a small number of surplus properties, held under operating leases, where it seeks to obtain rental income from a sub-lease to cover its ongoing liabilities under the head lease. In the event that a property held under one of these leases becomes vacant due to the expiry of a sub-lease, every effort is made to attract a new tenant. If there is likely to be a rental void for a period of time, then a provision is made at each balance sheet date to cover management's best estimate of the future cost of the likely void period.

(m) Share-based payments

The grant date fair value of share-based payments awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the awards. The fair value of the awards granted is measured using an option valuation model, taking into account the terms and conditions upon which the awards were granted. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

Details regarding the determination of the fair value of equity-settled share-based transactions are set out in note 25.

(n) Business combinations

The acquisition of subsidiaries is accounted for under the purchase method. The acquired business is measured at the date of acquisition as the aggregate fair value of assets, liabilities and contingent liabilities as required under IFRS 3 Business Combinations. The excess of the cost of acquisition over the fair value of the acquired business is represented as goodwill. Contingent consideration classified as a liability will be subsequently re-measured through the consolidated income statement under the requirements of the revised IFRS 3.

Notes to the financial statements

For the year ended 31 December 2016

1. Business and geographical segments

(a) Business segments

The Group adopted IFRS 8 'Operating Segments' with effect from 1 January 2009.

The Group's principal business segment is Packaging Distribution, comprising the distribution of packaging materials and supply of storage and warehousing services in the UK. This constitutes over 80% of the revenue and income of Group operations. The Group's Manufacturing Operations segment comprises the design, manufacture and assembly of timber, corrugated and foam-based packaging materials in the UK, the design, manufacture and supply of self-adhesive labels to a variety of FMCG customers in the UK and Europe and the design, manufacture and supply of resealable labels to a variety of FMCG customers in the UK, Europe and the USA. None of the individual business segments within Manufacturing Operations represent more than 10% of Group revenue or income.

External revenues from major products and services	2016 £000	2015 £000
Packaging Distribution	**155,900**	143,035
Design, manufacture and assembly of timber, corrugated and foam-based packaging materials	**9,298**	8,953
Manufacture and supply of self-adhesive labels	**8,079**	10,861
Manufacture and supply of resealable labels and related machinery	**6,495**	6,283
External revenues from continuing operations	**179,772**	169,132

(b) Segmental information

	Packaging Distribution £000	Manufacturing Operations £000	2016 Total £000	Packaging Distribution £000	Manufacturing Operations £000	2015 Total £000
Revenue						
Total revenue	156,187	28,031	**184,218**	143,265	31,017	174,282
Inter-segment revenue	(287)	(4,159)	**(4,446)**	(230)	(4,920)	(5,150)
External revenue	155,900	23,872	**179,772**	143,035	26,097	169,132
Cost of sales	(110,641)	(13,418)	**(124,059)**	(100,817)	(15,094)	(115,911)
Gross profit	45,259	10,454	**55,713**	42,218	11,003	53,221
Net operating expenses	(37,423)	(9,578)	**(47,001)**	(35,467)	(10,052)	(45,519)
Operating profit	7,836	876	**8,712**	6,751	951	7,702
Net finance costs			**(901)**			(935)
Profit before tax			**7,811**			6,767
Tax			**(1,761)**			(1,317)
Profit for the year from continuing operations			**6,050**			5,450

Inter-segment revenues are charged at prevailing market prices.

	Packaging Distribution £000	Manufacturing Operations £000	2016 Total £000	Packaging Distribution £000	Manufacturing Operations £000	2015 Total £000
Capital additions	9,714	368	**10,082**	4,045	400	4,445
Depreciation/amortisation	1,873	511	**2,384**	1,496	481	1,977
Segment assets	105,034	13,529	**118,563**	87,590	14,544	102,134
Segment liabilities	(72,503)	(6,737)	**(79,240)**	(61,625)	(7,037)	(68,662)
Net assets	32,531	6,792	**39,323**	25,965	7,507	33,472

(c) Geographical segments

The Group's operations are primarily located in the UK and Europe.

Packaging Distribution's activities are primarily in the UK. Within the Manufacturing Operations, the Packaging Design and Manufacture business operates primarily in the UK and the Labels businesses operate in the UK, Europe and through distributors in the USA.

	Continuing operations UK £000	Continuing operations Europe £000	2016 Total £000	Continuing operations UK £000	Continuing operations Europe £000	2015 Total £000
Revenue						
Total revenue	176,112	3,660	**179,772**	164,427	4,705	169,132
Result						
Operating result	8,618	94	**8,712**	7,308	394	7,702
Non-current assets	53,389	1,686	**55,075**	45,265	1,665	46,930
Capital additions	10,058	24	**10,082**	4,302	143	4,445

(d) Information about major customers

No single customer accounts for more than 5% of the Group's external revenues and customer dependencies are regularly monitored.

2. Operating profit

Operating profit has been arrived at after charging:	2016 £000	2015 £000
Depreciation of property, plant and equipment (see note 10)	**1,267**	1,151
Amortisation of other intangible assets (see note 9)	**1,117**	826
Staff costs (see note 3)	**27,770**	27,239

A detailed analysis of auditor's remuneration is provided below:

Audit services		
Fees payable to Company's auditor for the audit of the Company's annual accounts	**32**	30
Fees payable to Company's auditor for the audit of the Company's subsidiaries	**90**	79
Total audit fees	**122**	109
Non audit services		
Audit related assurance services for review of half-year statements	**10**	16
Other assurance services for the audit of Macfarlane Group PLC pension scheme	**9**	9
Taxation advisory services	**–**	6
All other services	**87**	104
Total non-audit fees	**106**	135
Total fees paid to auditor	**228**	244

In January 2015, our auditors KPMG LLP acquired Crimsonwing, a business providing IT services to the Group. Macfarlane Group first entered into a contractual relationship with Crimsonwing in 2010 and paid fees totalling £85,000 in 2016 (2015 – £95,000), which are classified within 'All other services' above.

Notes to the financial statements (continued)

For the year ended 31 December 2016

3. Staff costs

The average monthly number of employees was:	2016 No.	2015 No.
Production	**170**	172
Sales and distribution	**416**	389
Administration	**209**	187
	795	748

The costs incurred in respect of these employees were:	2016 £000	2015 £000
Wages and salaries	**24,191**	23,922
Social security costs	**2,296**	2,173
Other pension costs	**1,175**	1,072
Share-based payments	**108**	72
	27,770	27,239

4. Net finance costs

	2016 £000	2015 £000
Interest on bank borrowings	**(480)**	(460)
Interest on obligations under finance leases	**(48)**	(37)
Net interest expense on retirement benefit obligation (see note 24)	**(373)**	(438)
Net finance costs	**(901)**	(935)

5. Tax

	2016 £000	2015 £000
Current tax		
United Kingdom corporation tax	**(1,409)**	(1,134)
Foreign tax	**(79)**	(48)
Prior period adjustments	**83**	80
Current tax charge	**(1,405)**	(1,102)
Deferred tax		
Current period	**(196)**	(215)
Prior period adjustments	**(160)**	–
Deferred tax charge (see note 18)	**(356)**	(215)
Total tax charge	**(1,761)**	(1,317)

The standard rate of tax based on the UK average rate of corporation tax, is 20.00% (2015 – 20.25%). Taxation for other jurisdictions is calculated at the rates prevailing in these jurisdictions. The actual tax charge varies from of the standard rate of tax on the results as set out in the consolidated income statement for the reasons set out on the following page.

	2016 £000	2015 £000
Profit before tax	**7,811**	6,767
Tax on profit at 20.00% (2015 – 20.25%)	**(1,562)**	(1,370)
Factors affecting tax charge for the year:		
Non-deductible expenses	**(122)**	(37)
Difference on overseas tax rates	**–**	10
Changes in estimates related to prior years	**(77)**	80
Tax charge for the year	**(1,761)**	(1,317)
Effective tax rate for the year	**22.5%**	19.5%

A reduction in the UK corporation tax rate from 21% to 20% (effective from 1 April 2015) was substantively enacted on 2 July 2013. Further reductions to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Company's future current tax charge accordingly. The deferred tax asset at 31 December 2016 has been calculated based on these rates.

6. Profit for the year

The Company has taken advantage of Section 408 of the Companies Act 2006 and consequently a separate profit and loss account for the parent company is not presented as part of these financial statements. The Company's profit for the year is disclosed in note 35 to these financial statements.

7. Dividends

	2016 £000	2015 £000
Amounts recognised as distributions to equity holders in the year:		
Final dividend for 2015 of 1.29p per share (2014 – 1.15p per share)	**1,608**	1,433
Interim dividend for 2016 of 0.55p per share (2015 – 0.53p per share)	**750**	661
	2,358	2,094

In addition to the amounts shown above, a proposed dividend of 1.40p per share will be paid on 8 June 2017 to those shareholders on the register at 12 May 2017. This is subject to approval by shareholders at the Annual General Meeting on 9 May 2017 and therefore has not been included as a liability in these financial statements.

8. Earnings per share

	2016 £000	2015 £000
Earnings for the purposes of calculating earnings per share		
Profit for the year from continuing operations	**6,050**	5,450

Number of shares in issue for the purposes of calculating basic and diluted earnings per share	2016 Number of shares '000	2015 Number of shares '000
Weighted average number of shares in issue for the purposes of calculating basic earnings per share	**129,496**	124,611
Effect of Long-Term Incentive Plan awards in issue	**859**	576
Weighted average number of shares in issue for the purposes of calculating diluted earnings per share	**130,355**	125,187
Basic earnings per share	**4.67p**	4.37p
Diluted earnings per share	**4.64p**	4.35p

Notes to the financial statements (continued)

For the year ended 31 December 2016

9. Goodwill and other intangible assets

	Packaging Distribution £000	Manufacturing Operations £000	2016 Total £000	2015 Total £000
Goodwill	33,678	1,359	**35,037**	30,651
Other intangible assets	8,965	–	**8,965**	5,530
Goodwill and other intangible assets	**42,643**	**1,359**	**44,002**	36,181

Goodwill				
Fair value on acquisition				
At 1 January	29,292	1,359	**30,651**	29,007
Additions (see note 22)	4,386	–	**4,386**	1,644
At 31 December	**33,678**	**1,359**	**35,037**	30,651
Amortisation				
At 1 January and 31 December	**–**	**–**	**–**	–
Carrying amount				
At 31 December 2016	**33,678**	**1,359**	**35,037**	
At 31 December 2015	29,292	1,359		30,651

On 5 April 2016, the Group's subsidiary, Macfarlane Group UK Limited, acquired the business of Colton Packaging Teesside. On 3 May 2016, Macfarlane Group UK Limited also acquired the packaging business of Edward McNeil Limited. On 29 July 2016 the Group acquired Nelsons for Cartons & Packaging Limited. For all three acquisitions goodwill on acquisition arose, which was added to the Packaging Distribution CGU.

During 2015 the Group acquired One Packaging Limited, giving rise to goodwill on acquisition, which was added to the Packaging Distribution CGU.

At 31 December 2016, Macfarlane Group had two CGUs to which goodwill had been ascribed namely:

(i) Packaging Distribution, comprising goodwill arising on all acquisitions in this segment since 2001; and
(ii) Manufacturing Operations, comprising the goodwill arising on Labels acquisitions primarily in the Reseal-it business in 2000.

The recoverable amount of each CGU is determined using 'value in use' calculations with key assumptions relating to discount rates, growth rates and projected gross margin and overhead costs. A post-tax discount rate of 8.0% (2015 – 7.0%) is used for both CGU's reflecting the Group's weighted average cost of capital adjusted for appropriate market risk, which is considered to be the most definitive basis for arriving at a discount rate. The Group believes the risk profiles across the markets in which it operates are not significantly different and has therefore deemed it appropriate to apply the same discount rate to both CGUs. The pre-tax discount rate is 9.9% (2015 – 8.8%) for each CGU. Growth rates of 1%, changes in gross margin and overhead costs are based on our expectation of future performance in the markets in which we operate. These are consistent with our budgets for 2017 and strategic plans for future years, and extrapolate cash flows for five years after which a terminal value is calculated assuming no inherent growth.

The Directors believe the assumptions used are appropriate, but in addition have conducted sensitivity analysis to determine the changes in assumptions that would result in an impairment of the carrying value of goodwill. Based on this analysis the Directors believe that any reasonable changes in the key assumptions would maintain a recoverable amount for each CGU that exceeds its carrying value. Therefore at 31 December 2016 no impairment charge is required against the carrying value of goodwill.

	Brand values £000	Customer relationships £000	2016 Total £000	2015 Total £000
Other intangible assets				
Fair value on acquisition				
At 1 January	427	8,064	**8,491**	7,253
Additions (see note 22)	169	4,383	**4,552**	1,238
At 31 December	**596**	**12,447**	**13,043**	8,491
Amortisation				
At 1 January	207	2,754	**2,961**	2,135
Charge for year	81	1,036	**1,117**	826
At 31 December	**288**	**3,790**	**4,078**	2,961
Carrying amount				
At 31 December 2016	**308**	**8,657**	**8,965**	
At 31 December 2015	220	5,310		5,530

Other intangible assets comprise separately identifiable intangible assets recognised on the acquisitions of businesses and subsidiary companies in Packaging Distribution between 2008 and 2016. They are recorded at fair value on acquisition less subsequent amortisation.

These are primarily Brand values, which are calculated on acquisition on the Relief from Royalty method and a valuation of Customer Relationships, which is calculated on acquisition on the Excess Earnings method, based on the net anticipated earnings stream. Brand values are calculated on royalty rates of 0.5%, consistent with an assessment of what would be charged in a typical franchise agreement. The valuation of Customer Relationships is calculated using our best estimates of customer attrition rates, and returns, based on assessments of performance levels in the markets in which we operate. Brand values and Customer Relationships are amortised on a straight-line basis over up to five years and over ten years respectively.

On 5 April 2016, the Group's subsidiary, Macfarlane Group UK Limited, acquired the business of Colton Packaging Teesside. On 3 May 2016, Macfarlane Group UK Limited also acquired the packaging business of Edward McNeil Limited. On 29 July 2016 the Group acquired Nelsons for Cartons & Packaging Limited. For all three acquisitions, values for Brand Values and Customer Relationships within Packaging Distribution were recognised.

At 31 December 2016, Macfarlane Group retained Brand Values in respect of:

- Nelsons for Cartons & Packaging Limited, acquired in 2016;
- The packaging business of Edward McNeil Limited, acquired in 2016;
- The business of Colton Packaging Teesside, acquired in 2016;
- One Packaging Limited, acquired in 2015;
- Lane Packaging Limited, acquired in 2014; and
- Network Packaging Limited, also acquired in 2014.

At 31 December 2016, Macfarlane Group retained values of Customer Relationships in respect of:

- Online Packaging Limited, acquired in 2008;
- Allpoint Packaging Limited, acquired in 2008;
- Lane Packaging Limited, acquired in 2014;
- Network Packaging Limited, also acquired in 2014;
- One Packaging Limited, acquired in 2015;
- The business of Colton Packaging Teesside, acquired in 2016;
- The packaging business of Edward McNeil Limited, acquired in 2016; and
- Nelsons for Cartons & Packaging Limited, acquired in 2016.

Notes to the financial statements (continued)

For the year ended 31 December 2016

10. Property, plant and equipment

	Land and buildings £000	Plant and equipment £000	Total £000
Cost			
At 1 January 2015	5,986	21,938	27,924
Acquisitions	35	382	417
Additions	183	1,380	1,563
Exchange movements	–	(72)	(72)
Disposals	(295)	(82)	(377)
At 1 January 2016	**5,909**	**23,546**	**29,455**
Acquisitions	**31**	**375**	**406**
Additions	**350**	**794**	**1,144**
Exchange movements	**–**	**283**	**283**
Disposals	**(12)**	**(446)**	**(458)**
At 31 December 2016	**6,278**	**24,552**	**30,830**
Accumulated depreciation			
At 1 January 2015	2,751	17,728	20,479
Acquisitions	3	246	249
Charge for year	164	987	1,151
Exchange movements	–	(35)	(35)
Disposals	–	(80)	(80)
At 1 January 2016	**2,918**	**18,846**	**21,764**
Acquisitions	**21**	**190**	**211**
Charge for year	**221**	**1,046**	**1,267**
Exchange movements	**–**	**237**	**237**
Disposals	**(6)**	**(413)**	**(419)**
At 31 December 2016	**3,154**	**19,906**	**23,060**
Carrying amount			
At 31 December 2016	**3,124**	**4,646**	**7,770**
At 31 December 2015	2,991	4,700	7,691

The main components of property, plant and equipment are:

(i) Three properties owned by the Group in our Manufacturing Operations and tenant's improvements at a number of short and medium-term operating leases in Packaging Distribution, categorised as land and buildings.

(ii) A significant investment in plant and machinery in our Manufacturing Operations, typically printing presses in our Labels' businesses and corrugated case-making machinery in our Packaging Design and Manufacture business as well as investments in our IT hardware system in the Packaging Distribution and Packaging Design and Manufacture businesses, which are all categorised under the combined heading of plant and equipment.

The carrying value of £7,770,000 (2015 – £7,691,000) includes £1,342,000 (2015 – £1,563,000) of assets held under finance leases. Depreciation charged in respect of these assets is £228,000 (2015 – £123,000).

	2016 £000	2015 £000
Land and buildings at net book value comprise:		
Freeholds	**1,637**	1,664
Long leaseholds	**1,243**	1,219
Short leaseholds	**244**	108
	3,124	2,991

11. Subsidiary companies

A list of principal operating subsidiaries, including names, countries of incorporation and registered offices, is given on page 88.

12. Inventories

	2016 £000	2015 £000
Raw materials and consumables	**434**	399
Work in progress	**138**	181
Finished goods and goods for resale	**12,414**	9,979
	12,986	10,559

Inventories represent raw materials, work in progress and finished goods held at the year-end in each of the Group's businesses to respond to customers' requirements for product.

	2016 £000	2015 £000
Cost of inventories recognised as an expense in the consolidated income statement	**120,685**	112,067

Inventories recorded in the Group's balance sheet comprise large numbers of comparatively small balances. The local teams review inventory levels, older and obsolete inventories and provide against any exposures throughout the year. The Group's executive management then reviews these local judgements to ensure they properly reflect movements in absolute levels, ageing of holdings and known obsolescence.

Movement in the provisions for slow-moving and obsolete inventories	2016 £000	2015 £000
At 1 January	**709**	718
Additional provisions recognised in the consolidated income statement	**606**	58
Inventory written off during the year	**(622)**	(67)
At 31 December	**693**	709

13. Trade and other receivables

	2016 £000	2015 £000
Current		
Trade receivables	**42,492**	37,521
Allowance for doubtful receivables	**(326)**	(386)
	42,166	37,135
Other receivables	**4,210**	3,921
Prepayments and accrued income	**2,196**	2,182
	48,572	43,238
Non-current		
Other receivables	**425**	559

Trade receivables represent amounts owed by customers in respect of goods or services provided in the Group's businesses prior to the year-end.

Trade receivables are measured at amortised cost. The Group's credit risk is primarily attributable to its trade receivables. The average credit period taken on sales of goods is 60 days (2015 – 59 days). No interest is charged on overdue receivables.

The Group uses external credit scoring systems to assess new customers' credit quality and uses this to help define credit limits by customer. Limits and scoring are attributed to major customers, with receivables over £50,000 reviewed twice per year. There are no customers with a balance in excess of 5% of the total trade receivables balance at 31 December 2016 or 31 December 2015.

Included in the Group's trade receivables balance are debtors with a carrying amount of £11,835,000, (2015 – £11,153,000) which are past due at the reporting date. The Group has not provided for these amounts as there has not been a significant change in the customers' credit quality and the Group believes that the amounts are still recoverable. The weighted average overdue age of these trade receivables is 17 days (2015 – 18 days).

Notes to the financial statements (continued)

For the year ended 31 December 2016

13. Trade and other receivables (continued)

Ageing of past due but not impaired receivables	2016 £000	2015 £000
30 – 60 days	**6,577**	6,058
60 – 90 days	**4,263**	3,936
Over 90 days	**995**	1,159
	11,835	11,153

Amounts presented in the balance sheet are net of allowances for doubtful trade receivables of £326,000 (2015 – £386,000), estimated by the Group's executive management based on prior experience and their assessment of the current economic environment. In determining the recoverability of trade receivables, the Group's executive management considers any change in the credit quality of the trade receivables from the date credit was originally granted up to the reporting date.

Movement in the allowance for doubtful trade receivables	2016 £000	2015 £000
At 1 January	**386**	357
Impairment losses recognised in the consolidated income statement	**172**	170
Amounts written off as uncollectible	**(232)**	(141)
At 31 December	**326**	386

The Directors consider that the carrying amount of the trade and other receivables approximate to their fair value.

14. Financial instruments

The Group funds its operations from a number of sources of cash, namely operating cash flow, bank borrowings, finance lease borrowings and shareholders' equity, comprising share capital, reserves and retained earnings, where appropriate. The objective is to achieve a capital structure with an appropriate cost of capital whilst providing flexibility in immediate and medium-term funding to accommodate any material investment requirements.

The Group's principal financial instruments comprise borrowings, cash and short-term deposits, and other items, such as trade receivables and trade payables that arise directly from its operations. The main purpose of these financial instruments is to provide finance for the Group's operations. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments is undertaken for speculative purposes.

There has been no significant change to the Group's exposure to market risks during 2016. The principal risks arising are liquidity risk and credit risk, with the secondary risks being interest rate risk and currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained unchanged since the beginning of 2016.

Liquidity risk

The Group's liquidity requirements are met by ensuring adequate access to funds by maintaining appropriate levels of committed banking facilities, which are then reviewed on a regular basis. The Group bank borrowing facility with Lloyds Banking Group PLC is £25.0 million, available until June 2019, with an additional option to increase it further to £30.0 million. The facility bears interest at normal commercial rates and carries standard financial covenants in relation to interest cover and levels of headroom over the trade receivables of the Company. The maturity profile of debt outstanding at 31 December 2016 is set out in note 17 and in this note to the financial statements.

Credit risk

The Group's exposure to credit risk is managed by dealing only with banks and financial institutions with good credit ratings and by applying considerable rigour in managing trade receivables. The Group's principal credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are shown net of allowances for doubtful receivables, estimated by the Group's management with further details set out in note 13.

Interest rate risk

The Group finances its business through a mixture of equity and bank borrowings. The Group borrows in the desired currencies at floating rates of interest. It was not considered necessary to cover current interest rate exposures by the use of financial instruments during 2016.

A sensitivity analysis has been determined based on the exposure to interest rates at the reporting date and the stipulated change taking place at the beginning of the financial year and held constant throughout the reporting period. If the interest rates had been 50 basis points higher and all other variables held constant, the Group's profit before tax would have decreased by £82,000 (2015 – £70,000).

Currency risk

The Group has two overseas subsidiaries, one operating in Ireland and the other operating in Sweden. Revenues and expenses are denominated exclusively in Euros and Swedish Krone respectively. As a result, movements in the Euro and Swedish Krone to sterling exchange rates could affect the Group's sterling balance sheet. The Group's policy during 2016 has been to review the need to hedge exposures on a regular basis and it was not considered necessary to cover the existing currency exposures by the use of financial instruments. The Group continues to review the need to hedge exposures on a regular basis.

The Sterling value of foreign currency denominated assets and liabilities at the reporting date is as follows:

	Assets 2016 £000	Assets 2015 £000	Liabilities 2016 £000	Liabilities 2015 £000
Euros	**1,505**	1,439	**651**	505
Swedish Krone	**647**	615	**221**	227
	2,152	2,054	**872**	732

The sterling value of the Group's foreign currency denominated profit/(loss) before tax is as follows:

	2016 £000	2015 £000
Euros	**(230)**	173
Swedish Krone	**340**	225
	110	398

The following table details the Group's sensitivity to a 5% change in Sterling against the respective foreign currencies. The sensitivity of the Group's exposure to foreign currency risk is determined based on the change taking place at the beginning of the financial year and held constant throughout the reporting period.

	Result 2016 £000	Result 2015 £000	Other equity 2016 £000	Other equity 2015 £000
Euros	**(12)**	9	**43**	47
Swedish Krone	**17**	11	**21**	19
	5	20	**64**	66

Cash and cash equivalents	2016 £000	2015 £000
Currency		
Sterling	**1,646**	955
Euros	**259**	444
Swedish Krone	**25**	8
Cash and cash equivalents	**1,930**	1,407
Bank borrowings and loans		
Currency – Sterling	**17,206**	13,039
Bank borrowings and loans	**17,206**	13,039
Net debt	**15,276**	11,632

Cash and cash equivalents as set out above comprise cash at bank and other short-term highly liquid investments with maturity of three months or less.

The Group bank borrowing arrangement with Lloyds Banking Group PLC comprises a three-year committed borrowing facility of up to £25.0 million with an additional option to increase it further to £30.0 million. The facility is available until June 2019 and bears interest at normal commercial rates and carries standard financial covenants in relation to interest cover and levels of headroom over the trade receivables of the Company.

Interest rates

All Group deposits and borrowings are held at floating rates of interest. The average effective interest rate on bank borrowings approximates to 2.9% per annum (2015 – 3.3%).

Notes to the financial statements (continued)

For the year ended 31 December 2016

14. Financial instruments (continued)

Fair value of financial instruments

Current assets and liabilities are all held at floating rates. The fair values of cash and cash equivalents and bank borrowings at 31 December 2016 all materially equate to book values.

Borrowing facilities

The Group has various committed borrowing facilities available at 31 December 2016, in respect of which all conditions precedent had been met, as follows:

	2016 £000	2015 £000
Drawn down	**17,206**	13,039
Undrawn	**8,994**	7,861
	26,200	20,900

The Group's borrowing profile is as follows:		
At amortised cost		
Bank borrowings – secured	**17,206**	13,039
Finance lease liabilities – secured	**395**	388
Current borrowings	**17,601**	13,427
Non-current – finance lease liabilities – secured	**402**	738
Total borrowings	**18,003**	14,165

The principal Group borrowing facilities of £25.0 million at 31 December 2016 (2015 – £20.0 million) are with Lloyds Banking Group PLC and there are three smaller facilities totalling £1.2 million (2015 – £0.9 million), inherited as part of the acquisitions between 2014 and 2016.

The Group is currently in compliance with all conditions in relation to each of these borrowing facilities.

Gearing ratio	2016 £000	2015 £000
Total borrowings (as defined previously)	**18,003**	14,165
Equity	**39,323**	33,472
Net debt to equity ratio	**46%**	42%

Financial instruments carried at fair value

IFRS 7 requires that all financial instruments carried at fair value be analysed under certain levels. The table below analyses financial instruments, into a fair value hierarchy based on the valuation technique used to determine fair value.

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair values of all financial assets and financial liabilities by class together with their carrying amounts shown in the balance sheet are as follows:

Financial assets designated as fair value through profit or loss (note 15)	Carrying amount 2016 £000	Fair value 2016 £000	Level 1 2016 £000	Level 2 2016 £000	Level 3 2016 £000	Carrying amount 2015 £000	Fair value 2015 £000	Level 1 2015 £000	Level 2 2015 £000	Level 3 2015 £000
Contingent consideration	**1,700**	**1,700**	**–**	**–**	**1,700**	2,063	2,063	–	–	2,063

The following table shows the valuation techniques used for Level 3 fair values, as well as the significant unobservable inputs used for Level 3 items.

Financial instruments measured at fair value	Valuation technique	Significant unobservable inputs (Level 3 only)
Contingent consideration	The expected payment reflects the calculated cash out flows under possible earn out scenarios and is not discounted	Trading performance of acquired businesses or subsidiary companies

15. Trade and other payables

	2016 £000	2015 £000
Due within one year		
Trade payables	**34,500**	30,690
Other taxation and social security	**2,678**	2,845
Contingent consideration	**950**	2,063
Other creditors	**551**	226
Accruals and deferred income	**4,523**	5,473
	43,202	41,297
Due after more than one year		
Contingent consideration	**750**	–
Other creditors	**31**	40
	781	40

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing distribution costs and administrative expenses in all the Group's businesses. No interest is charged on trade payables.

The Directors consider that the carrying amounts for trade and other payables approximate to their fair value.

16. Provisions

	2016 £000	2015 £000
Due within one year		
At 1 January	**–**	52
Credited to consolidated income statement	**–**	(20)
Paid in the year	**–**	(32)
At 31 December	**–**	–

The Company reassesses the provision made for residual lease commitments together with other outgoings for dilapidations, after taking into account existing sub-tenant arrangements and assumptions relating to potential later periods of vacancy.

17. Finance lease liabilities

	2016 £000	2015 £000
Amounts payable under finance leases		
Due within one year	**395**	388
Due between one and two years	**303**	432
Due from the third to fifth years inclusive	**99**	306
Present value of finance lease liabilities	**797**	1,126
Due for settlement within 12 months (shown within current liabilities)	**(395)**	(388)
Due for settlement after more than 12 months (shown as non-current liabilities)	**402**	738

The Group determines the need to use external arrangements to finance tangible assets, depending on the cost, availability and balance of its other funding arrangements. The Group typically uses such arrangements to finance major capital projects, but often inherits financing arrangements on acquisition of subsidiary companies.

The average lease term is three years and the average effective borrowing rate is 2.50% per annum (2015 – 2.50%). Interest rates are fixed at the contract date. All liabilities are on a fixed repayment basis. Finance lease liabilities are denominated in Sterling.

The Directors consider that the carrying amounts for finance lease liabilities approximate to their fair value.

The finance lease liabilities are secured over the assets to which the leases relate as disclosed in note 10.

Notes to the financial statements (continued)

For the year ended 31 December 2016

18. Deferred tax

	Tax losses less accelerated capital allowances £000	Other intangible assets £000	Retirement benefit obligations £000	Total £000
At 1 January 2015	474	(1,023)	2,775	2,226
Acquisition (see note 22)	–	(249)	–	(249)
(Charged)/credited in income statement	(41)	277	(451)	(215)
(Charged) in other comprehensive income				
Deferred tax on remeasurement of pension scheme liability	–	–	(22)	(22)
Long-term corporation tax rate change	–	–	(229)	(229)
At 1 January 2016	**433**	**(995)**	**2,073**	**1,511**
Acquisition (see note 22)	**–**	**(828)**	**–**	**(828)**
(Charged)/credited in income statement				
Current period	**(26)**	**286**	**(456)**	**(196)**
Prior period adjustments	**(160)**	**–**	**–**	**(160)**
Credited/(charged) in other comprehensive income				
Deferred tax on remeasurement of pension scheme liability	**–**	**–**	**1,000**	**1,000**
Long-term corporation tax rate change	**–**	**–**	**(146)**	**(146)**
At 31 December 2016	**247**	**(1,537)**	**2,471**	**1,181**

2016				
Deferred tax asset				
Due outwith one year	**407**	**–**	**2,471**	**2,878**
Deferred tax liabilities				
Due outwith one year	**(160)**	**(1,537)**	**–**	**(1,697)**
	247	**(1,537)**	**2,471**	**1,181**
2015				
Deferred tax asset				
Due outwith one year	426	–	2,073	2,499
Deferred tax liabilities				
Due outwith one year	7	(995)	–	(988)
	433	(995)	2,073	1,511

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

Reductions in the UK corporation tax rate to 17% (effective from 1 April 2020) were substantively enacted on 6 September 2016. This will reduce the Company's future current tax charge accordingly. The deferred tax asset at 31 December 2016 has been calculated based on these rates.

Recovery of the deferred tax assets is anticipated against future trading profits.

19. Share capital

	Number of 25p shares	2016 £000	2015 £000
Allotted, issued and fully paid:			
At 1 January	124,611,360	**31,153**	31,153
Issued during the year	11,724,137	**2,931**	–
At 31 December	136,335,497	**34,084**	31,153

The Company has one class of ordinary shares, which carry no right to fixed income. Each ordinary share carries one vote in any General Meeting of the Company.

On 26 July 2016, the Company announced a placing of 10,000,000 ordinary shares of 25p each at a price of 58p per share. These shares were admitted to the official List of the London Stock Exchange on 29 July 2016.

On 29 July 2016, the Company acquired the whole issued share capital of Nelsons for Cartons & Packaging Limited. As part of the initial consideration, the Company issued 1,724,137 ordinary shares of 25p each at a value of 58p per share to the Vendors, for a total value of £1,000,000, which were also admitted to the official List of the London Stock Exchange on 29 July 2016.

20. Reserves

	Share premium £000	Revaluation reserve £000	Translation reserve £000	Retained earnings £000
Balance at 1 January 2015	1,018	70	121	(2,116)
Profit for the year	–	–	–	5,450
Dividends paid (see note 7)	–	–	–	(2,094)
Foreign currency translation differences – foreign operations	–	–	(62)	–
Credit for share-based payments	–	–	–	72
Remeasurement of pension scheme liability taken direct to equity	–	–	–	111
Deferred tax taken direct to equity				
Tax on remeasurement	–	–	–	(22)
Long-term corporation tax rate change	–	–	–	(229)
Balance at 1 January 2016	**1,018**	**70**	**59**	**1,172**
Profit for the year	**–**	**–**	**–**	**6,050**
Dividends paid (see note 7)	**–**	**–**	**–**	**(2,358)**
Issue of new shares	**3,869**	**–**	**–**	**–**
Expenses of share issue	**(246)**	**–**	**–**	**–**
Foreign currency translation differences – foreign operations	**–**	**–**	**195**	**–**
Credit for share-based payments	**–**	**–**	**–**	**108**
Remeasurement of pension scheme liability taken direct to equity	**–**	**–**	**–**	**(5,552)**
Deferred tax taken direct to equity				
Tax on remeasurement	**–**	**–**	**–**	**1,000**
Long-term corporation tax rate change	**–**	**–**	**–**	**(146)**
Balance at 31 December 2016	**4,641**	**70**	**254**	**274**

Exchange differences arising in the consolidated accounts on the retranslation at closing rates of the Group's net investments in foreign subsidiary companies are recorded as movements on the Group's translation reserve.

The translation reserve at 31 December 2016 relates wholly to continuing operations.

Notes to the financial statements (continued)

For the year ended 31 December 2016

21. Notes to the cash flow statement

	2016 £000	2015 £000
Operating profit	**8,712**	7,702
Adjustments for:		
Amortisation of intangible assets	**1,117**	826
Depreciation of property, plant and equipment	**1,267**	1,151
(Gain)/loss on disposal of property, plant and equipment	**(18)**	34
Operating cash flows before movements in working capital	**11,078**	9,713
Increase in inventories	**(885)**	(546)
Increase in receivables	**(3,450)**	(2,042)
Increase in payables	**1,280**	2,178
Decrease in provisions	**–**	(32)
Pension scheme contributions	**(2,906)**	(2,682)
Cash generated by operations	**5,117**	6,589
Income taxes paid	**(1,295)**	(724)
Interest paid	**(528)**	(497)
Net cash inflow from operating activities	**3,294**	5,368

	2016 £000	2015 £000
Movement in net debt		
Increase in cash and cash equivalents	**523**	157
Increase in bank borrowings	**(4,167)**	(1,690)
New finance lease facilities	**–**	(813)
Cash flows from payment of finance lease liabilities	**329**	320
Movement in net debt in the year	**(3,315)**	(2,026)
Opening net debt	**(12,758)**	(10,732)
Closing net debt	**(16,073)**	(12,758)
Net debt comprises:		
Cash and cash equivalents in statement of cash flows	**1,930**	1,407
Bank borrowings	**(17,206)**	(13,039)
Net bank debt	**(15,276)**	(11,632)
Finance lease liabilities		
Due within one year	**(395)**	(388)
Due outwith one year	**(402)**	(738)
Closing net debt	**(16,073)**	(12,758)

Cash and cash equivalents (which are presented as a single class of asset on the face of the balance sheet) comprise cash at bank and other short-term highly liquid investments with maturity of three months or less.

22. Acquisition of subsidiary companies

On 5 April 2016, the Group's subsidiary, Macfarlane Group UK Limited, acquired the business of Colton Packaging Teesside, for a consideration of approximately £1.3 million. £1.1 million was paid in cash on acquisition, with the deferred consideration of £0.2 million payable in the second quarter of 2017, if the earn-out target for the year to 31 March 2017 is achieved. On 3 May 2016, Macfarlane Group UK Limited also acquired the packaging business of Edward McNeil Limited, for a consideration of approximately £1.7 million. £1.6 million was paid in cash on acquisition, with the deferred consideration of £0.1 million payable in the next twelve months, based on certain working capital targets. On 29 July 2016, the Group acquired 100% of the issued share capital of Nelsons for Cartons & Packaging Limited, a packaging distributor, for a consideration of approximately £7.2 million. £4.7 million was paid in cash on acquisition, and £1.0 million was settled by the issue of shares. The deferred consideration of £1.5 million, is payable in two equal instalments in the final quarters of 2017 and 2018, subject to certain trading targets being met in the two twelve month periods ending on 29 July 2017 and 29 July 2018 respectively. Contingent consideration is recognised as a liability in creditors and is remeasured to fair value at the balance sheet date on a range of outcomes between £Nil and £1.7 million.

In 2015 the Group acquired 100% of One Packaging Limited for a consideration of £2.7 million. £2.0 million was paid in cash on acquisition, with the deferred consideration of £0.7 million paid in 2016 as the earn-out target for the year to 31 July 2016 has been met. In 2014 the Group acquired Network Packaging Limited with deferred consideration on acquisition of £2.6 million. £1.3 million of this was paid in 2015 with the remainder of £1.3 million paid in 2016 following the achievement of the earn-out target.

The impact of the acquisitions on the 2016 results is set out in the Strategic Report on page 8.

All of these businesses are accounted for in the Packaging Distribution segment. Goodwill arising on these acquisitions is attributable to the anticipated future profitability of the distribution of Group product ranges in the UK and anticipated operating synergies from future combinations of activities with the Packaging Distribution network. Fair values assigned to net assets acquired and consideration paid and payable are set out below:

	2014/2015 acquisitions £000	Colton Teesside and Edward McNeil £000	Nelsons for Cartons & Packaging £000	2016 Total £000	2015 Total £000
Net assets acquired					
Other intangible assets (note 9)	–	1,619	2,933	**4,552**	1,238
Property, plant and equipment	–	25	170	**195**	168
Inventories	–	628	914	**1,542**	350
Trade and other receivables	–	–	1,728	**1,728**	1,098
Cash and bank balances	–	–	696	**696**	–
Bank loans and overdrafts	–	–	–	**–**	(403)
Trade and other payables	–	–	(1,837)	**(1,837)**	(974)
Current tax liabilities	–	–	(256)	**(256)**	–
Finance lease liabilities	–	–	(7)	**(7)**	(59)
Deferred tax liabilities	–	(292)	(536)	**(828)**	(249)
Net assets acquired	–	1,980	3,805	**5,785**	1,169
Goodwill arising on acquisition (note 9)	–	1,041	3,345	**4,386**	1,644
Total consideration	–	3,021	7,150	**10,171**	2,813
Contingent consideration on acquisitions					
Current year	–	(320)	(1,500)	**(1,820)**	–
Prior year	2,063	–	–	**2,063**	725
Shares	–	–	(1,000)	**(1,000)**	–
Total cash consideration	2,063	2,701	4,650	**9,414**	3,538
Net cash outflow arising on acquisition					
Cash consideration	(2,063)	(2,701)	(4,650)	**(9,414)**	(3,538)
Cash and bank balances acquired	–	–	696	**696**	–
Bank loans and overdrafts assumed	–	–	–	**–**	(403)
Net cash outflow	(2,063)	(2,701)	(3,954)	**(8,718)**	(3,941)

Notes to the financial statements (continued)

For the year ended 31 December 2016

23. Financial commitments

The Group's property portfolio in its Packaging Distribution business comprises a number of property leases for periods of between one year and ten years. In addition the Group leases most of its commercial vehicles, motor vehicles, fork lift trucks and telecoms equipment on leasing arrangements, which run for periods of up to six years.

These arrangements are collectively known as operating leases.

During the year the Group made minimum lease payments under non-cancellable operating leases as follows:

	Land and buildings 2016 £000	Other 2016 £000	Land and buildings 2015 £000	Other 2015 £000
Charge for the year	**4,546**	**2,347**	4,277	2,755
Recoveries from property sub-leases	**(478)**	**–**	(548)	–
Net charge for the year	**4,068**	**2,347**	3,729	2,755

At the balance sheet date the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases which fall due for payment as follows:

	Land and buildings 2016 £000	Other 2016 £000	Land and buildings 2015 £000	Other 2015 £000
Within one year	**4,613**	**2,326**	4,341	2,750
Between one and five years	**12,784**	**3,867**	11,599	4,663
After more than five years	**5,264**	**106**	5,217	37
	22,661	**6,299**	21,157	7,450

The majority of the 29 (2015 – 28) leases of land and buildings summarised above are subject to rent reviews. 3 (2015 – 4) of these leases are subject to sub-let arrangements or assignations with third parties to reduce the property cost to Macfarlane Group.

At the balance sheet date there were outstanding commitments for future annual minimum lease payments receivable under non-cancellable operating leases which fall due for payment to the Group as follows:

	Land and buildings 2016 £000	Land and buildings 2015 £000
Within one year	**478**	538
Between one and five years	**1,216**	1,684
After more than five years	**–**	10
	1,694	2,232

In the event of tenants defaulting on future payments under non-cancellable operating leases for land and buildings, this would lead to increased property costs to the Group until the leases were subsequently sub-let.

Following the assignment of a property head lease at Coventry in October 2011, the Group provided guarantees for the rentals under the head lease in the event of a default by the assignee. The assignee is the UK subsidiary of a multinational business listed on the New York Stock Exchange. As a result of the assignation, there is a contingent liability of £1.8 million, (2015 – £2.3 million) being the difference between head lease and sub-lease payments from 1 January 2017 until the conclusion of the head lease in November 2020.

Contractual commitments for capital expenditure for which no provision has been made in the accounts amounted to £Nil (2015 – £Nil).

24. Retirement benefit obligations

Introduction

Macfarlane Group PLC sponsors a defined benefit pension scheme for certain active and former UK employees – the Macfarlane Group PLC Pension & Life Assurance Scheme (1974) ('the scheme'). Two trading subsidiaries, Macfarlane Group UK Limited and Macfarlane Labels Limited are also sponsoring employers of the scheme. Disclosure of the respective proportions of the Group deficit are set out in the accounts of each of the three participating employers.

The scheme is administered by a separate Board of Trustees composed of employer-nominated representatives and member-nominated Trustees and is legally separate from the Group. The assets of the scheme are held separately from those of the Group in managed funds under the supervision of the Trustees. The Trustees are required by law to act in the interest of all classes of beneficiary in the scheme and are responsible for investment policy and the day-to-day administration of benefits. The scheme was closed to new entrants during 2002.

The scheme provides qualifying employees with an annual pension of 1/60 of pensionable salary for each completed year's service on attainment of a normal retirement age of 65. Pensionable salaries were frozen for the remaining active members at the levels current at 30 April 2009 with the change taking effect from 30 April 2010. As a result no further salary inflation applies for active members who elected to remain in the scheme. Active members' benefits also include life assurance cover, albeit the payment of these benefits is at the discretion of the Trustees of the scheme.

On withdrawing from active service a deferred member's pension is revalued from the time of withdrawal until the pension is drawn. Revaluation in deferment is statutory and since 2010 has been revalued on the Consumer Price Index ('CPI') measure of inflation. Revaluation of pensions in payment is a blend of fixed increases and inflationary increases depending on the relevant periods of accrual of benefit. For pensions in payment, the inflationary increase is currently based on the Retail Price Index ('RPI') measure of inflation or based on Limited Price Indexation ('LPI') for certain defined periods of service.

During 2012, Macfarlane Group PLC agreed with the Board of Trustees to amend benefits for pensioner, deferred and active members in the defined benefit pension scheme by offering a Pension Increase Exchange ('PIE') option for deferred and active members after 1 May 2012.

The Group will consider further actions to reduce the deficit in 2017.

Balance sheet disclosures at 31 December 2016

The pension scheme's qualified actuary from Aon Hewitt carries out triennial valuations using the Projected Unit Credit Method to determine the level of deficit. For the most recent triennial valuation at 1 May 2014, the principal assumptions adopted were that investment returns would average 0.7% per annum above the gilt yield and that no salary increases would apply for active members. The valuation showed that the market value of the relevant investments of the scheme was £58,676,000 and the actuarial value of these investments represented 71% of the value of benefits that had accrued to members.

The investments held by the scheme and the deficit of the scheme have been based on the results of the actuarial valuation as at 1 May 2014, updated to the year-end as shown below:

Investment class	Valuation 2016 £000	Asset allocation	Valuation 2015 £000	Asset allocation	Valuation 2014 £000	Asset allocation
Equities						
UK equities and equity funds	**6,604**	8.5%	6,030	8.9%	5,677	8.4%
Overseas equities funds	**10,508**	13.5%	10,758	15.9%	10,216	15.0%
Multi-asset diversified funds	**21,509**	27.7%	25,476	37.6%	18,541	27.3%
Bonds						
Liability-driven investment funds	**26,532**	34.1%	14,107	20.8%	22,195	32.6%
European loan fund	**6,334**	8.1%	–	–	–	–
Corporate bond funds	**–**	–	11,119	16.4%	11,263	16.6%
Other						
Cash	**6,321**	8.1%	303	0.4%	98	0.1%
Fair value of scheme assets	**77,808**	100.0%	67,793	100.0%	67,990	100.0%
Present value of scheme liabilities	**(92,345)**		(79,311)		(81,863)	
Deficit in the scheme	**(14,537)**		(11,518)		(13,873)	

Notes to the financial statements (continued)

For the year ended 31 December 2016

24. Retirement benefit obligations (continued)

The Trustees review the investments of the scheme on a regular basis and consult with the Company regarding any proposed changes to the investment profile. During 2016, the interest rate and inflation rate protection in the scheme was increased by adding to the Liability-driven investment funds, a new European loan fund was added to the portfolio and both of these investments were financed by the disposal of the Corporate Bond fund holding.

The ability to realise the Scheme's assets at, or very close to, fair value was considered when setting the investment strategy. The Scheme's investment strategy has 84% of the assets being able to be realised at fair value on a daily or weekly basis. The remaining assets have monthly or quarterly liquidity, however, whilst the income from these helps to meet the Scheme's cashflow needs, they are not expected to require to be realised at short notice.

The present value of the scheme liabilities is derived from cash flow projections over a long period and is thus inherently uncertain.

Assumptions

The scheme's liabilities at 31 December 2016 were calculated on the following bases as required under IAS19:

	2016	2015	2014
Discount rate	**2.70%**	3.70%	3.50%
Rate of increase in salaries	**0.00%**	0.00%	0.00%
Rate of increase in pensions in payment	**3% or 5% for fixed increases or 3.20% for LPI. 2.25% post 5 April 2006**	3% or 5% for fixed increases or 2.90% for LPI. 2.10% post 5 April 2006	3% or 5% for fixed increases or 3.30% for LPI. 2.05% post 5 April 2006
Inflation assumption (RPI)	**3.30%**	3.10%	3.00%
Inflation assumption (CPI)	**2.30%**	2.10%	2.10%
Life expectancy beyond normal retirement age of 65			
Male	**22.8**	22.7	22.7
Female	**25.3**	25.3	25.1

Sensitivity to significant assumptions

The scheme exposes the Group to actuarial risks, such as interest rate risk, inflation risk, longevity risk and investment risk. The significant assumptions used for IAS 19 are discount rate, inflation and mortality. If different assumptions were used, then this could have a material effect on the deficit disclosed. Assuming all other assumptions are held static then a movement in the following key assumptions would affect the level of the deficit as shown below:

	2016 £000	2015 £000	2014 £000
Assumptions			
Discount rate movement of +0.1%	**1,478**	1,142	1,285
Inflation rate movement of +0.1%	**(471)**	(404)	(393)
Mortality movement of +0.1 year in age rating	**277**	214	295

Positive figures reflect a reduction in the scheme liabilities and therefore a reduction in the scheme deficit.

The sensitivity information has been prepared using the same method as adopted when adjusting the results of the latest funding valuation to the balance sheet date and is consistent with the approach adopted in previous years.

It is set out in this manner to enable calculations of larger movements to be undertaken relatively easily.

The mortality movement of +0.1 year in age rating equates to current movements in life expectancy tables.

All of the sensitivity information assumes that the average duration of liabilities in the scheme is seventeen years.

Funding

UK pension legislation requires that pension schemes are funded prudently. Following the 2014 actuarial valuation, the scheme's trustees agreed to a deficit recovery period of 10 years. Macfarlane Group PLC is currently paying deficit reduction contributions of £2,861,000 per annum, which along with investment returns from return-seeking assets is expected to make good the actuarial shortfall by April 2024. The estimated deficit reduction contributions in 2017 will be £2,890,000.

The employer contribution rate for active members is 18.6% of pensionable salary and the employee contribution rate is 7% of pensionable salary from 1 May 2015.

The next triennial actuarial valuation of the scheme is due at 1 May 2017.

Movement in the scheme deficit in the year	2016 £000	2015 £000
At 1 January	**(11,518)**	(13,873)
Current service costs	**(95)**	(152)
Contributions from sponsoring companies	**3,001**	2,834
Net finance cost	**(373)**	(438)
Remeasurement of pension scheme liability in the year	**(5,552)**	111
At 31 December	**(14,537)**	(11,518)
Analysis of amounts charged to profit before tax		
Current service costs	**(95)**	(152)
Net finance cost	**(373)**	(438)
Pension expense charged to profit before tax	**(468)**	(590)
Analysis of the remeasurement of pension scheme liability as included in the statement of other comprehensive income		
Return on scheme assets excluding amount shown in interest income	**9,610**	(1,658)
Changes in assumptions underlying the present value of scheme liabilities	**(15,162)**	1,769
Remeasurement of pension scheme liability recognised in the statement of other comprehensive income	**(5,552)**	111
Movement in the fair value of scheme assets		
At 1 January	**67,793**	67,990
Interest income	**2,470**	2,364
Return on scheme assets excluding amount shown in interest income	**9,610**	(1,658)
Contributions from sponsoring companies	**3,001**	2,834
Contribution from scheme members	**72**	84
Benefits paid	**(5,138)**	(3,821)
At 31 December	**77,808**	67,793
Movement in the present value of defined benefit obligations		
At 1 January	**(79,311)**	(81,863)
Normal service costs	**(95)**	(152)
Interest cost	**(2,843)**	(2,802)
Contribution from scheme members	**(72)**	(84)
Changes in assumptions underlying the defined benefit obligations	**(15,162)**	1,769
Benefits paid	**5,138**	3,821
At 31 December	**(92,345)**	(79,311)

The total of £15,162,000, (2015 – £1,769,000) set out above includes changes arising from scheme experience as well as changes in the underlying assumptions of the defined benefit obligations.

The cumulative amount of actuarial losses recognised in other comprehensive income since the date of transition to IAS 19 on 1 January 2004 is £21,648,000 (2015 – £16,096,000).

Notes to the financial statements (continued)

For the year ended 31 December 2016

24. Retirement benefit obligations (continued)

The history of experience adjustments and actual returns on scheme assets and scheme liabilities is as follows:

	2016 £000	2015 £000	2014 £000	2013 £000	2012 £000
Present value of defined benefit obligations	**(92,345)**	(79,311)	(81,863)	(70,134)	(70,247)
Fair value of scheme assets	**77,808**	67,793	67,990	54,238	51,349
Deficit in the scheme	**(14,537)**	(11,518)	(13,873)	(15,896)	(18,898)
Actual return on scheme assets					
Amount	**12,080**	706	11,672	3,710	4,307
Percentage of scheme assets	**15.5%**	1.0%	17.2%	6.8%	8.4%
Experience adjustment on scheme liabilities					
Amount	**(15,162)**	1,769	(11,921)	(292)	(3,827)
Percentage of scheme liabilities	**(16.4%)**	2.2%	(14.6%)	(0.4%)	(5.4%)
Experience adjustment on scheme assets					
Amount	**9,610**	(1,658)	9,184	1,469	2,051
Percentage of scheme assets	**12.4%**	(2.4%)	13.5%	2.7%	4.0%

Defined contribution schemes

The Group also operates a number of defined contribution pension schemes, set up as Group Personal Pension Plans, including an Auto-enrolment plan. The assets of these plans are held separately from those of the Group in independently administered funds. The pension cost charge represents contributions paid by the Group to these plans and amounted to £1,080,000 (2015 – £920,000). Contributions amounting to £109,000 (2015 – £58,000) were payable to the plans and are included in creditors at the balance sheet date.

25. Share-based payments

Equity-settled long-term incentive plans

The Macfarlane Group PLC Long Term Incentive Plan.

Long Term Incentive Plan Awards	Exercise date	Number of shares 2016	Number of shares 2015
Outstanding at 1 January		**1,135,280**	–
Granted during the year	7 May 2018	**–**	1,135,280
Outstanding at 31 December		**1,135,280**	1,135,280

A nominal-cost option award was granted under The Macfarlane Group PLC Long Term Incentive Plan on 8 May 2015 based on 100% of salary. The performance condition requires EPS in 2017 to be 5.75p-6.53p for 25%-100% of this part of the award to vest, working on a straight-line basis. The awards are also subject to positive Total Shareholder Return and the achievement of certain sales levels over the performance period. No re-setting of the award is allowed. The vesting period is three years and no awards were exercisable at 31 December 2016. Awards are forfeited if the employee leaves the Group before they vest.

The Group recognised an expense of £108,000 (2015 – £72,000) in 2016 relating to equity-settled long-term incentive plan awards. The fair value at 31 December 2016 was £180,000 (2015 – £72,000).

Inputs to the binomial model giving rise to a charge are as follows:	2016	2015
Weighted average share price	**29.43p**	29.43p
Weighted average exercise price	**Nil**	Nil
Expected volatility	**23.50%**	23.50%
Risk free rate	**0.79%**	0.79%
Expected annual dividend yield	**3.86%**	3.86%

26. Related party transactions

The Group has related party relationships with

(i) its subsidiaries (see page 88),
(ii) its Directors who comprise the Group Board; and
(iii) the Macfarlane Group PLC sponsored pension schemes (see note 24).

Transactions between the Company and its subsidiaries are eliminated on consolidation and are not disclosed.

Key management personnel comprise the Group Board. Their remuneration is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures'.

	2016 £000	2015 £000
Directors' Remuneration	**910**	879
Employer's national insurance contributions	**126**	121
	1,036	1,000

Further details of Directors' individual and collective remuneration are set out in the Report on Directors' Remuneration on page 29. The details provided in the Report on Directors' Remuneration address the Companies Act disclosure requirements relating to Directors' remuneration.

Details of Directors' shareholdings in the Company are also shown on page 30 and total dividends of £43,000 were paid in respect of these shareholdings in 2016 (2015 – £38,000).

Disclosures in relation to the pension schemes are set out in note 24.

The Directors have considered the implications of IAS24 'Related Party Disclosures' and are satisfied that there are no other related party transactions occurring during the year, which require disclosure other than those already disclosed in these financial statements.

Company balance sheet

At 31 December 2016

	Note	2016 £000	2015 £000
Non-current assets			
Tangible fixed assets	28	**39**	39
Investments	29	**39,544**	32,394
Deferred tax asset	30	**989**	829
Debtors	31	**9,493**	8,381
		50,065	41,643
Current assets			
Debtors	31	**2,660**	4,348
Cash at bank and in hand		**3**	3
Total current assets		**2,663**	4,351
Creditors – amounts falling due within one year	32	**(1,476)**	(3,272)
Net current assets		**1,187**	1,079
Total assets less current liabilities		**51,252**	42,722
Creditors – amounts falling due after more than one year	33	**(1,690)**	(940)
Net assets excluding pension liability		**49,562**	41,782
Pension liability	39	**(5,815)**	(4,607)
Net assets		**43,747**	37,175
Capital and reserves			
Share capital	34	**34,084**	31,153
Share premium	35	**4,641**	1,018
Profit and loss account	35	**5,022**	5,004
Shareholders' funds	36	**43,747**	37,175

The accompanying notes are an integral part of this Company balance sheet.

The financial statements of Macfarlane Group PLC, company registration number SC004221, were approved by the Board of Directors on 23 February 2017 and signed on its behalf by

Peter D. Atkinson
Chief Executive

John Love
Finance Director

Company statement of changes in equity

For the year ended 31 December 2016

	Note	Share capital £000	Share premium £000	Retained earnings £000	Total £000
At 1 January 2015		31,153	1,018	3,529	35,700
Comprehensive income					
Profit for the year		–	–	2,887	2,887
Remeasurement of pension scheme liability	39	–	–	879	879
Tax on remeasurement of pension scheme liability		–	–	(158)	(158)
Long-term corporation tax rate change		–	–	(111)	(111)
Total comprehensive income		–	–	3,497	3,497
Transactions with shareholders					
Dividends	7	–	–	(2,094)	(2,094)
Share-based payments	38	–	–	72	72
Total transactions with shareholders		–	–	(2,022)	(2,022)
At 31 December 2015		**31,153**	**1,018**	**5,004**	**37,175**
Comprehensive income					
Profit for the year		**–**	**–**	**3,553**	**3,553**
Remeasurement of pension scheme liability	39	**–**	**–**	**(1,497)**	**(1,497)**
Tax on remeasurement of pension scheme liability		**–**	**–**	**269**	**269**
Long-term corporation tax rate change		**–**	**–**	**(57)**	**(57)**
Total comprehensive income		**–**	**–**	**2,268**	**2,268**
Transactions with shareholders					
Dividends	7	**–**	**–**	**(2,358)**	**(2,358)**
Share-based payments	38	**–**	**–**	**108**	**108**
Issue of share capital	34,35	**2,931**	**3,623**	**–**	**6,554**
Total transactions with shareholders		**2,931**	**3,623**	**(2,250)**	**4,304**
At 31 December 2016		**34,084**	**4,641**	**5,022**	**43,747**

The accompanying notes are an integral part of this statement of changes in equity.

Notes to the Company financial statements

For the year ended 31 December 2016

27. Significant accounting policies

Macfarlane Group PLC is a public company listed on the London Stock Exchange, incorporated and domiciled in the UK.

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ('FRS 101'). The amendments to FRS 101 (2014/15 Cycle) issued in July 2015 and effective immediately have been applied.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ('Adopted IFRSs'), but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

(i) Cash flow statement and related notes;
(ii) Comparative period reconciliations for share capital and tangible fixed assets;
(iii) Disclosures in respect of transactions with wholly owned subsidiaries;
(iv) The effects of new but not yet effective IFRSs; and
(v) Disclosures in respect of the compensation of Key Management Personnel.

As the consolidated financial statements for Macfarlane Group PLC include the equivalent disclosures, the Company has also applied the exemptions available under FRS 101 in respect of certain disclosures required by IFRS 3 Business Combinations relating to business combinations undertaken by the Company.

The Directors, in their consideration of going concern, have reviewed the Company and Group's future cash flow forecasts and revenue projections, which they believe are based on a prudent assessment of the market and past experience. Additional details are set out on pages 49 and 50. After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for at least the next twelve months. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Application of accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the preparation of these financial statements.

The financial statements are prepared on the historical cost basis except that certain of the following assets and liabilities are stated at their fair value.

Tangible fixed assets

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. No depreciation is provided on land. Depreciation is calculated at fixed rates on a straight-line basis to write off the cost or valuation of the assets to their estimated residual values over the period of their expected useful lives. The rates of depreciation vary between 2%-5% per annum on property and 7%-25% per annum on plant and equipment. Rates of depreciation are reviewed annually to ensure they remain relevant and residual values are reviewed once in each calendar year.

Investments

Investments held as fixed assets are stated in note 29 at cost less any provision for impairment.

Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other debtors, cash and cash equivalents, loans and borrowings, and trade and other creditors.

Trade and other debtors

Trade and other debtors are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method, less any impairment losses.

Trade and other creditors

Trade and other creditors are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases are charged to the profit and loss account on a straight-line basis over the term of the relevant lease.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for management services provided to Group undertakings, net of VAT. Revenue is recognised as the related costs are incurred.

Financial instruments

Financial assets and financial liabilities are recognised in the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Financial assets

Financial assets, categorised as investments, are recognised and derecognised on the effective date where the purchase or sale of an investment is under a contract whose terms require the delivery of the investment within the timeframe established. They are initially measured at fair value, net of transactions costs except for those financial assets classified at fair value through the income statement, which are initially measured at fair value.

Other financial assets comprise trade and other debtors that have fixed or determinable recoveries and are classified as trade and other debtors. The classification takes account of the nature and purpose of the financial assets and is determined on initial recognition. These are measured at amortised cost less impairment.

Indicators are assessed for the impairment of financial assets at each balance sheet date. Financial assets are impaired when there is objective evidence that as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows have been impacted. For trade and other debtors the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows.

The carrying amount of the financial asset is reduced by the impairment loss.

Cash and cash equivalents comprise cash on hand and on demand deposits, readily convertible to a known amount of cash and are subject to insignificant risk of changes in value.

Financial liabilities and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements.

Financial liabilities comprise solely other financial liabilities under the terms of IFRS 7. Financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost, with interest expense measured on an effective yield basis.

Equity instruments are any contracts evidencing a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments were not used in the current or preceding financial year.

Contingent consideration classified as a liability will be subsequently re-measured through the income statement under the requirements of the revised IFRS 3.

Share-based payments

The grant date fair value of share-based payments awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the awards. The fair value of the awards granted is measured using an option valuation model, taking into account the terms and conditions upon which the awards were granted. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

Details regarding the determination of the fair value of equity-settled share-based transactions are set out in note 38.

Notes to the Company financial statements (continued)

For the year ended 31 December 2016

27. Significant accounting policies (continued)

Taxation

The tax expense represents the sum of the current tax payable and deferred tax.

Current tax is payable based on the taxable profit for the year. Taxable profit differs from profit before tax as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The current tax liability is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax balances represent the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax assets and liabilities are not discounted.

The carrying value of deferred tax 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 to allow all or part of the asset to be recovered.

Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been substantively enacted at the balance sheet date. Deferred tax is charged or credited in the profit and loss account, except when it relates to items charged or credited in other comprehensive income, in which case the deferred tax is also recorded in the statement of other comprehensive income.

Retirement benefit costs

Defined contribution schemes

A defined contribution plan is a post-employment benefit plan under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the profit and loss account in the periods during which services are rendered by employees.

Defined benefit schemes

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net retirement benefit obligation in respect of its defined benefit pension plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods. These benefits are then discounted to determine the present value, and the fair value of any plan investments, at bid price, are deducted. The Group determines the net interest on the net retirement benefit obligation for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the year.

The discount rate is set in consultation with the Company's pension advisers, representing the yield at the reporting date on bonds that have a credit rating of at least AA that have maturity dates approximating to the average duration of the Group's retirement benefit obligations and that are denominated in the currency in which the benefits are expected to be paid.

Remeasurements arising from defined benefit plans comprise actuarial gains and losses, returns on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest). Remeasurements are recognised in the statement of other comprehensive income and all other expenses related to defined benefit plans charged in staff costs in the profit and loss account.

When the benefits of a plan are changed, or when a plan is curtailed, the portion of the changed benefit related to past service by employees, or the gain or loss on curtailment, is recognised immediately in the profit and loss account when the plan amendment or curtailment occurs.

The calculation of the retirement benefit obligations is performed by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Group, the recognised asset is limited to the present value of benefits available in the form of any future refunds from the plan or reductions in future contributions and takes into account the adverse effect of the present value of any minimum funding requirements.

The net defined benefit cost of the plan is apportioned to participating entities on the basis of the employment history of scheme members, who are allocated to the relevant subsidiary company, with any remaining unallocated members being charged to the parent company.

28. Tangible fixed assets

	Land and buildings £000	Plant and equipment £000	Total £000
Cost			
At 1 January 2016 and 31 December 2016	**15**	**305**	**320**
Depreciation			
At 1 January 2016	**13**	**268**	**281**
Charge for year	**–**	**–**	**–**
At 31 December 2016	**13**	**268**	**281**
Net book value			
At 31 December 2016	**2**	**37**	**39**
At 31 December 2015	2	37	39

The parent company does not hold any assets under finance leases.

29. Investments

	2016 £000	2015 £000
Investment in subsidiaries at cost		
At 1 January	**32,394**	29,942
Additions	**7,150**	2,732
Disposals	**–**	(280)
At 31 December	**39,544**	32,394

Details of the principal operating subsidiaries are set out on page 88.

On 29 July 2016, the Company acquired 100% of the issued share capital of Nelsons for Cartons & Packaging Limited for a consideration of £7,150,000. £4,650,000 was paid in cash on acquisition, £1,000,000 was settled by the issue of shares. The contingent consideration of £1,500,000, is payable in two equal instalments in the final quarter of 2017 and 2018, subject to certain trading targets being met in the two twelve month periods ending on 29 July 2017 and 29 July 2018 respectively and is shown in creditors as contingent consideration.

30. Deferred tax asset

	2016 £000	2015 £000
Deferred tax on pension scheme deficit		
At 1 January	**829**	1,138
Credited/(charged) to reserves	**212**	(269)
Charged to profit and loss account	**(52)**	(40)
At 31 December	**989**	829

Recovery of the deferred tax asset is anticipated against future taxable profits.

Notes to the Company financial statements (continued)

For the year ended 31 December 2016

31. Debtors

	2016 £000	2015 £000
Due within one year		
Amounts owed by subsidiary undertakings	**1,150**	3,000
Other receivables	**683**	577
Prepayments and accrued income	**507**	438
Deferred tax asset (see below)	**320**	333
	2,660	4,348
Deferred tax asset		
Corporation tax losses		
At 1 January	**333**	370
Charged to profit and loss account	**(13)**	(37)
At 31 December	**320**	333

Recovery of the deferred tax asset for corporation tax losses is anticipated against future taxable profits.

	2016 £000	2015 £000
Due after more than one year		
Amounts owed by subsidiary undertakings	**9,493**	8,381

32. Creditors – amounts falling due within one year

	2016 £000	2015 £000
Bank borrowings	**17**	445
Trade creditors	**259**	298
Other taxation and social security	**41**	37
Contingent consideration	**750**	2,063
Corporation tax	**78**	146
Accruals and deferred income	**331**	283
	1,476	3,272

The Company is a party to the Group bank borrowing facility with Lloyds Banking Group PLC, which comprises a three-year committed borrowing facility of up to £25.0 million, available until June 2019, with an additional option to increase it further to £30.0 million. The facility bears interest at normal commercial rates and carries standard financial covenants in relation to interest cover and levels of headroom over the trade debtors of Macfarlane Group UK Limited.

The Company and certain subsidiaries have given inter-company guarantees to secure the drawdown on this facility. The drawdown at 31 December 2016 by the subsidiary company, Macfarlane Group UK Limited amounted to £16.4 million.

33. Creditors – amounts falling due after more than one year

	2016 £000	2015 £000
Contingent consideration	**750**	–
Amounts owed to subsidiary undertakings	**940**	940
	1,690	940

34. Share capital

	Number of 25p shares	2016 £000	2015 £000
Called up, allotted and fully paid:			
At 1 January	124,611,360	**31,153**	31,153
Issued during the year	11,724,137	**2,931**	–
At 31 December	136,335,497	**34,084**	31,153

The Company has one class of ordinary shares, which carry no right to fixed income. Each ordinary share carries one vote in any General Meeting of the Company.

On 26 July 2016, the Company announced a placing of 10,000,000 ordinary shares of 25p each at a price of 58p per share. These shares were admitted to the official List of the London Stock Exchange on 29 July 2016.

On 29 July 2016, the Company acquired the whole issued share capital of Nelsons for Cartons & Packaging Limited. As part of the initial consideration, the Company issued 1,724,137 ordinary shares of 25p each at a value of 58p per share to the Vendors, for a total value of £1,000,000, which were also admitted to the official List of the London Stock Exchange on 29 July 2016.

35. Reserves

	Share premium £000	Profit and loss account £000	Total £000
Balance at 1 January 2015	1,018	3,529	4,547
Profit for the year	–	2,887	2,887
Dividends paid (see note 7)	–	(2,094)	(2,094)
Credit for share-based payments (see note 38)	–	72	72
Post tax actuarial gain in pension scheme taken direct to reserves	–	610	610
Balance at 1 January 2016	**1,018**	**5,004**	**6,022**
Profit for the year	**–**	**3,553**	**3,553**
Dividends paid (see note 7)	**–**	**(2,358)**	**(2,358)**
Credit for share-based payments (see note 38)	**–**	**108**	**108**
Issue of new shares	**3,869**	**–**	**3,869**
Expenses of share issue	**(246)**	**–**	**(246)**
Post tax actuarial loss in pension scheme taken direct to reserves	**–**	**(1,285)**	**(1,285)**
Balance at 31 December 2016	**4,641**	**5,022**	**9,663**

36. Reconciliation of movements in shareholders' funds

	2016 £000	2015 £000
Profit for the year	**3,553**	2,887
Dividends to equity holders in the year	**(2,358)**	(2,094)
Post tax actuarial (loss)/gain in pension scheme taken direct to equity	**(1,285)**	610
Credit for share-based payments	**108**	72
Issue of new shares (net of issue expenses)	**6,554**	–
Movements in shareholders' funds in the year	**6,572**	1,475
Opening shareholders' funds	**37,175**	35,700
Closing shareholders' funds	**43,747**	37,175

Notes to the Company financial statements (continued)

For the year ended 31 December 2016

37. Operating profit

		2016 £000	2015 £000
Operating profit for the parent company has been arrived at after charging:			
Auditor's remuneration	Audit services	**19**	13
	Non-audit services	**12**	15

	2016 No.	2015 No.
Staff costs		
The average monthly number of employees was:		
Administration	**11**	11

	2016 £000	2015 £000
The costs incurred in respect of these employees were:		
Wages and salaries	**1,149**	1,098
Social security costs	**131**	141
Other pension costs	**24**	28
	1,304	1,267

38. Share-based payments

Equity-settled long-term incentive plans

The Macfarlane Group PLC Long Term Incentive Plan.

Long Term Incentive Plan Awards	Exercise date	Number of shares 2016	Number of shares 2015
Outstanding at 1 January		**1,135,280**	–
Granted during the year	7 May 2018	**–**	1,135,280
Outstanding at 31 December		**1,135,280**	1,135,280

A nominal-cost option award was granted under The Macfarlane Group PLC Long Term Incentive Plan on 8 May 2015 based on 100% of salary. The performance condition requires EPS in 2017 to be 5.75p-6.53p for 25%-100% of this part of the award to vest, working on a straight-line basis. The awards are also subject to positive Total Shareholder Return and the achievement of certain sales levels over the performance period. No re-setting of the award is allowed.

The vesting period is three years and no awards were exercisable at 31 December 2016.

Awards are forfeited if the employee leaves the Group before they vest.

The Company recognised an expense of £108,000 (2015 – £72,000) in 2016 relating to equity-settled long-term incentive plan awards. The fair value at 31 December 2016 was £180,000 (2015 – £72,000). The expense relates entirely to employees of the parent company.

Inputs to the binomial model giving rise to a charge are as follows:	2016	2015
Weighted average share price	**29.43p**	29.43p
Weighted average exercise price	**Nil**	Nil
Expected volatility	**23.50%**	23.50%
Risk free rate	**0.79%**	0.79%
Expected annual dividend yield	**3.86%**	3.86%

39. Pensions

Introduction

Macfarlane Group PLC sponsors a defined benefit pension scheme for certain active and former UK employees – the Macfarlane Group PLC Pension & Life Assurance Scheme (1974) ('the scheme'). Two trading subsidiaries, Macfarlane Group UK Limited and Macfarlane Labels Limited are also sponsoring employers of the scheme. Disclosure of the respective proportions of the Group deficit are set out in the accounts of each of the three participating employers.

The scheme is administered by a separate Board of Trustees composed of employer-nominated representatives and member-nominated Trustees and is legally separate from the Group. The assets of the scheme are held separately from those of the Group in managed funds under the supervision of the Trustees. The Trustees are required by law to act in the interest of all classes of beneficiary in the scheme and are responsible for investment policy and the day-to-day administration of benefits. The scheme was closed to new entrants during 2002.

The scheme provides qualifying employees with an annual pension of 1/60 of pensionable salary for each completed year's service on attainment of a normal retirement age of 65. Pensionable salaries were frozen for the remaining active members at the levels current at 30 April 2009 with the change taking effect from 30 April 2010. As a result no further salary inflation applies for active members who elected to remain in the scheme. Active members' benefits also include life assurance cover, albeit the payment of these benefits is at the discretion of the Trustees of the scheme.

On withdrawing from active service a deferred member's pension is revalued from the time of withdrawal until the pension is drawn. Revaluation in deferment is statutory and since 2010 has been revalued on the Consumer Price Index ('CPI') measure of inflation. Revaluation of pensions in payment is a blend of fixed increases and inflationary increases depending on the relevant periods of accrual of benefit. For pensions in payment, the inflationary increase is currently based on the Retail Price Index ('RPI') measure of inflation or based on Limited Price Indexation ('LPI') for certain defined periods of service.

During 2012, Macfarlane Group PLC agreed with the Board of Trustees to amend benefits for pensioner, deferred and active members in the defined benefit pension scheme by offering a Pension Increase Exchange ('PIE') option for deferred and active members after 1 May 2012.

The Group will consider a number of further actions to reduce the deficit in 2017.

Balance sheet disclosures at 31 December 2016

The pension scheme's qualified actuary from Aon Hewitt carries out triennial valuations using the Projected Unit Credit Method to determine the level of deficit. For the most recent triennial valuation at 1 May 2014, the principal assumptions adopted were that investment returns would average 0.7% per annum above the gilt yield and that no salary increases would apply for active members. The valuation showed that the market value of the relevant investments of the scheme was £58,676,000 and the actuarial value of these investments represented 71% of the value of benefits that had accrued to members.

The investments held by the scheme and the deficit of the scheme have been based on the results of the actuarial valuation as at 1 May 2014, updated to the year-end to reflect amounts attributable to Macfarlane Group PLC, the parent company as shown below:

Investment class	Valuation 2016 £000	Valuation 2015 £000	Valuation 2014 £000
Equities	**6,845**	6,716	6,516
Multi-asset diversified funds	**8,603**	10,190	7,602
Bonds	**2,534**	4,448	4,617
Liability-driven investment funds	**10,613**	5,642	9,100
Cash	**2,528**	122	41
Fair value of scheme assets	**31,123**	27,118	27,876
Present value of scheme liabilities	**(36,938)**	(31,725)	(33,564)
Deficit in the scheme	**(5,815)**	(4,607)	(5,688)

The ability to realise the Scheme's assets at, or very close to, fair value was considered when setting the investment strategy. The Scheme's investment strategy has 84% of the assets being able to be realised at fair value on a daily or weekly basis. The remaining assets have monthly or quarterly liquidity, however, whilst the income from these helps to meet the Scheme's cashflow needs, they are not expected to require to be realised at short notice.

The present value of the scheme liabilities is derived from cash flow projections over a long period of time and is thus inherently uncertain.

Notes to the Company financial statements (continued)

For the year ended 31 December 2016

39. Pensions (continued)

The scheme's liabilities at 31 December 2016 were calculated on the following bases as required under FRS17:

Assumptions	2016	2015	2014
Discount rate	**2.70%**	3.70%	3.50%
Rate of increase in salaries	**0.00%**	0.00%	0.00%
Rate of increase in pensions in payment	**3% or 5% for fixed increases or 3.20% for LPI. 2.25% post 5 April 2006**	3% or 5% for fixed increases or 2.90% for LPI. 2.10% post 5 April 2006	3% or 5% for fixed increases or 3.30% for LPI. 2.05% post 5 April 2006
Inflation assumption (RPI)	**3.30%**	3.10%	3.00%
Inflation assumption (CPI)	**2.30%**	2.10%	2.10%
Life expectancy beyond normal retirement age of 65			
Male	**22.8**	22.7	22.7
Female	**25.3**	25.3	25.1

Movement in the scheme deficit in the year	2016 £000	2015 £000
At 1 January	**(4,607)**	(5,688)
Current service cost	**(13)**	(20)
Contributions	**450**	397
Other financial charges	**(148)**	(175)
Remeasurement of pension scheme liability in the year	**(1,497)**	879
At 31 December	**(5,815)**	(4,607)
Analysis of amounts charged to operating profit		
Current service cost	**(13)**	(20)
Analysis of amounts charged to other financial charges		
Expected return on pension scheme assets	**989**	946
Interest cost of pension scheme liabilities	**(1,137)**	(1,121)
Other financial charges	**(148)**	(175)
Analysis of the remeasurement of the pension scheme liability		
Actual return less expected return on scheme assets	**4,610**	(585)
Changes in assumptions underlying the present value of the scheme's liabilities	**(6,107)**	1,464
Remeasurement of pension scheme liability	**(1,497)**	879

	2016 £000	2015 £000
Movement in the fair value of scheme assets		
At 1 January	**27,118**	27,876
Expected return on scheme assets	**989**	946
Actual return less expected return on scheme assets	**4,610**	(585)
Contributions paid by Company	**450**	397
Contribution from scheme members	**8**	12
Benefits paid	**(2,052)**	(1,528)
At 31 December	**31,123**	27,118
Movement in the present value of defined benefit obligations		
At 1 January	**(31,725)**	(33,564)
Service costs	**(13)**	(20)
Interest costs	**(1,137)**	(1,121)
Contribution from scheme members	**(8)**	(12)
Actuarial (loss)/gain in the year	**(6,107)**	1,464
Benefits paid	**2,052**	1,528
At 31 December	**(36,938)**	(31,725)

The cumulative remeasurement of the pension liability applied against reserves since the transition to IAS 19 on 1 January 2004 is a loss of £3,821,000 (2015 – £2,324,000).

	2016 £000	2015 £000	2014 £000	2013 £000	2012 £000
Present value of defined benefit obligations	**(36,938)**	(31,725)	(33,564)	(28,755)	(28,801)
Fair value of scheme assets	**31,123**	27,118	27,876	22,238	21,053
Deficit in the scheme	**(5,815)**	(4,607)	(5,688)	(6,517)	(7,748)
Return on scheme assets	**5,599**	361	6,341	2,340	2,481
Percentage of scheme assets	**18.0%**	1.3%	22.7%	10.5%	11.8%
Experience adjustment to scheme assets	**4,610**	(585)	5,320	1,176	1,380
Percentage of scheme assets	**14.8%**	(2.2%)	19.0%	5.3%	6.6%
Experience adjustment on scheme liabilities	**(6,107)**	1,464	(4,946)	(184)	(1,630)
Percentage of scheme liabilities	**(16.5%)**	4.6%	(14.7%)	(0.6%)	(5.7%)

Defined contribution schemes

The Company also participated in a defined contribution scheme, the Macfarlane Group Personal Pension Plan. Contributions to the plan for the year were £11,000 (2015 – £3,000) with no contributions payable to the plan at the balance sheet date.

40. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed. The Directors have considered the implications of IAS24 'Related Party Disclosures' and are satisfied that there are no other related party transactions occurring during the year, which require disclosure, other than those already disclosed in these financial statements.

Principal operating subsidiaries and related undertakings

Company name	Principal activities	Country of registration
Macfarlane Group UK Limited [1] Coventry Tel: 02476 511511 Grantham Tel: 01476 574747 Westbury Tel: 01373 858555	Supply and distribution of all forms of packaging materials and equipment. Design and manufacture of specialist packaging.	England
Network Packaging Limited [3] Wolverhampton Tel: 01902 496666	Supply and distribution of all forms of packaging materials and equipment.	England
One Packaging Limited [4] Bingham Tel: 01949 837666	Supply and distribution of all forms of packaging materials and equipment.	England
Nelsons for Cartons & Packaging Limited [5] Leicester Tel: 0116 2641050	Supply and distribution of all forms of packaging materials and equipment.	England
Macfarlane Labels Limited [6] Kilmarnock Tel: 01563 525151	Manufacture of high quality printed self-adhesive labels and resealable labelling solutions.	Scotland
Macfarlane Group Ireland (Labels & Packaging) Limited [7] Wicklow Tel: 00 353 1281 0234	Manufacture of high quality printed self-adhesive labels and resealable labelling solutions and supply and distribution of all forms of packaging materials and equipment.	Ireland
Macfarlane Group Sweden AB [8] Helsingborg Tel: 00 46 42 13 75 55	Provision of high quality printed self-adhesive labels and resealable labelling solutions.	Sweden

All the above subsidiaries are wholly owned either by Macfarlane Group PLC or one of its subsidiary companies and operate within their country of registration. The Company controls 100% of the ordinary share capital of each subsidiary. The Company's other related undertakings are the dormant subsidiary undertakings disclosed below. In all cases the Company listed as owner controls 100% of the issued share capital of the subsidiary undertaking.

Company name	Company number	Country of registration
Owned By Macfarlane Group Plc		
Centurion Packaging (Holdings) Limited [1]	02355761	England
National Packaging Group Limited [1]	01355867	England
Adhesive Labels Limited [1]	00723320	England
Owned by Macfarlane Group UK Limited		
Online Packaging Limited [1]	02903657	England
Allpoint Packaging Limited [1]	03930806	England
Bloomfield Supplies Limited [1]	02253938	England
Macfarlane Packaging Limited [2]	SC041678	Scotland
Macfarlane Merchanting Limited [1]	00372831	England
Abbott's Packaging Limited [1]	01385800	England
Mitchell Packaging Limited [1]	00535311	England
Owned by Network Packaging Limited		
Network Display Products Limited [3]	07185175	England
Networkpack Limited [3]	07076439	England
Owned by Nelsons for Cartons & Packaging Limited		
Nelsons for Storage Solutions Limited [5]	08878287	England
Owned by Macfarlane Group Sweden AB		
ReSeal-it Scandinavia [8]	556480-9845	Sweden
Regath HB [8]	969610-8753	Sweden

Registered offices

[1] Siskin Parkway East, Middlemarch Business Park, Coventry CV3 4PE
[2] 21 Newton Place, Glasgow G3 7PY
[3] Unit 5, Lanesfield Drive, Spring Road Industrial Estate, Ettingshall, Wolverhampton WV4 6UA
[4] Unit D6, Moorbridge Road, Bingham, Nottingham NG13 8GG
[5] The Point, Granite Way, Mountsorrel, Loughborough LE12 7TZ
[6] Bentinck Street, Kilmarnock KA1 4AS
[7] Kilmacullagh, Newtownmountkennedy, Co. Wicklow, Ireland
[8] Kapplöpningsgatan 14, 252 30 Helsingborg, Sweden

Five year record

	2016 £000	2015 £000	2014 £000	2013 £000	2012 £000
Turnover – all operations	**179,772**	169,132	153,767	143,871	141,823
Operating profit	**8,712**	7,702	6,646	6,251	5,834
Net interest payable	**(901)**	(935)	(1,040)	(1,199)	(1,349)
Profit before exceptional items	**7,811**	6,767	5,606	5,052	4,485
Exceptional items	**–**	–	–	(336)	993
Profit before tax	**7,811**	6,767	5,606	4,716	5,478
Taxation	**(1,761)**	(1,317)	(1,164)	(1,260)	(1,613)
Profit for the financial year	**6,050**	5,450	4,442	3,456	3,865
Diluted earnings per ordinary share	**4.64p**	4.35p	3.78p	3.03p	3.40p
Dividends	**2,358**	2,094	1,888	1,774	1,761
Dividends paid per ordinary share	**1.84p**	1.68p	1.60p	1.55p	1.55p
Dividend cover	**2.6**	2.6	2.4	1.9	2.2

This table reflects the five-year record for continuing operations as classified at 31 December 2016.

Financial diary

Financial results

Interim: Announced – August
Final: Announced – February

Accounts and annual general meeting

Report and financial statements – Posted to shareholders on 31 March 2017
Annual General Meeting – Held in Glasgow on 9 May 2017

Shareholder enquiries

Macfarlane Group PLC's ordinary shares are classified under the 'Industrial – General' section of the Industrial Sector on the London Stock Exchange.

Enquiries regarding shareholdings, dividend payments, dividend mandate instructions, lost share certificates, tax vouchers, changes of address, transfers of shares to another person and other administrative matters should be addressed to the Company's registrars:

Equiniti
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA

Telephone: 0871 384 2439
Fax: 0871 384 2100
Website: www.shareview.co.uk

The Company's website, www.macfarlanegroup.com provides details of all major Stock Exchange announcements, details of the current share price and information about Macfarlane Group's business.

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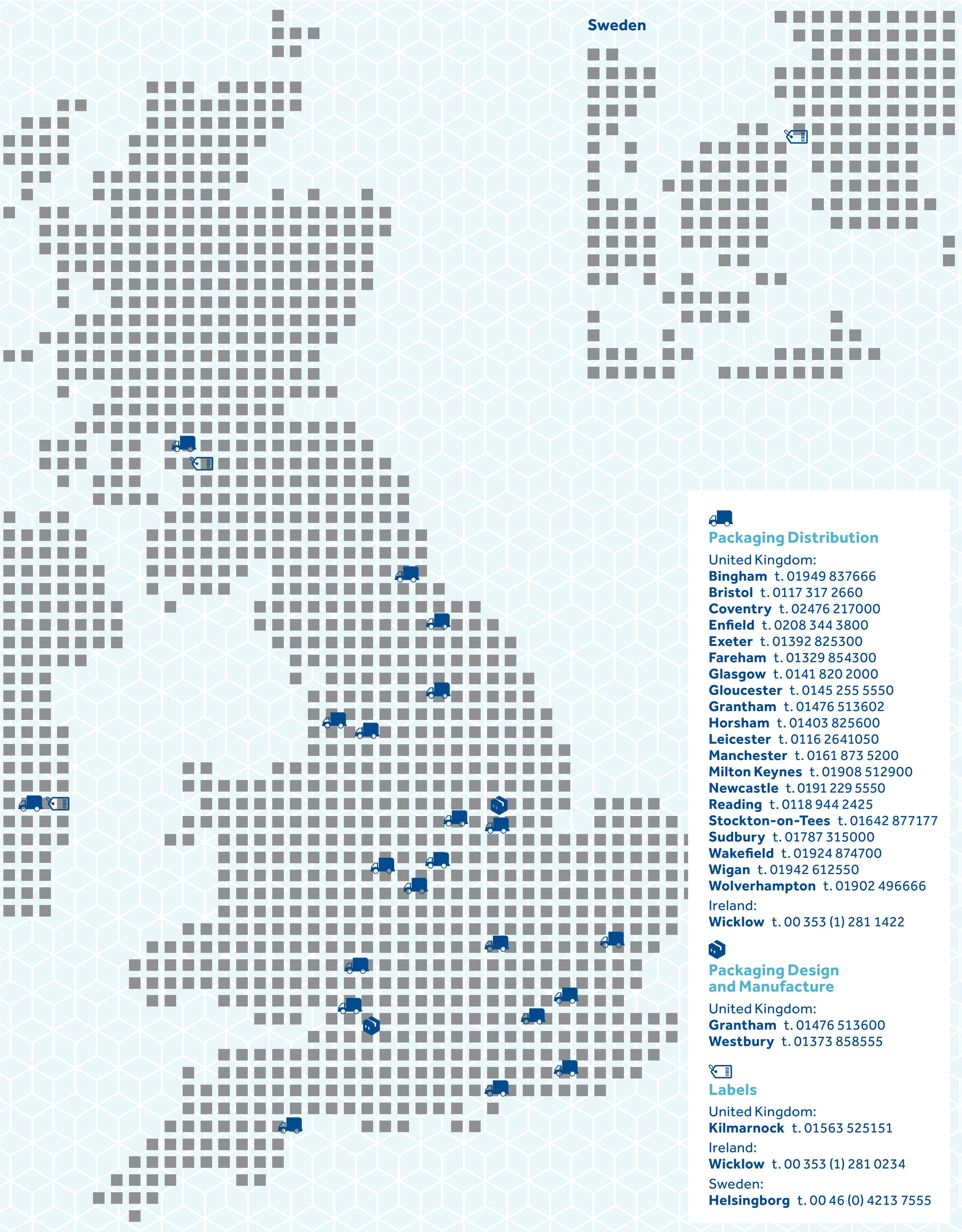

Packaging Distribution

United Kingdom:
Bingham t. 01949 837666
Bristol t. 0117 317 2660
Coventry t. 02476 217000
Enfield t. 0208 344 3800
Exeter t. 01392 825300
Fareham t. 01329 854300
Glasgow t. 0141 820 2000
Gloucester t. 0145 255 5550
Grantham t. 01476 513602
Horsham t. 01403 825600
Leicester t. 0116 2641050
Manchester t. 0161 873 5200
Milton Keynes t. 01908 512900
Newcastle t. 0191 229 5550
Reading t. 0118 944 2425
Stockton-on-Tees t. 01642 877177
Sudbury t. 01787 315000
Wakefield t. 01924 874700
Wigan t. 01942 612550
Wolverhampton t. 01902 496666
Ireland:
Wicklow t. 00 353 (1) 281 1422

Packaging Design and Manufacture

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