IMPROVING HOMES, IMPROVING NEIGHBOURHOODS, IMPROVING LIVES

# Mears Group PLC | Annual Report and Accounts 2006

MEARS

GROUP PLC

# welcome...

**We are the leading social housing repairs and maintenance provider in the UK. We achieve the highest levels of financial performance and innovation in our sector.**

2,500 people work at Mears. Together with our clients, we maintain, repair and upgrade people's homes. We carry out more than 1,750 repairs each day to 500,000 houses nationwide. Our customer service philosophy is simple: **we want to make tenants smile.**

Our results in 2006 underline the financial and operational strengths of this Group.



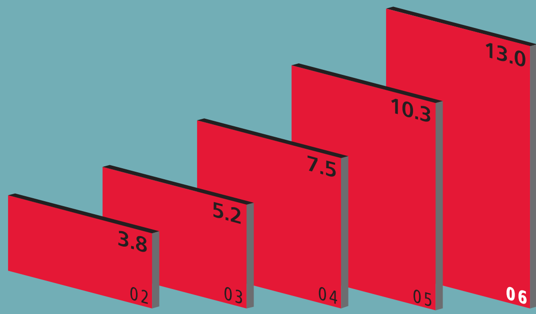
**SOCIAL HOUSING TURNOVER UP 27.7%**
£184.0m (2005: £144.1m)

**ORDER BOOK £1.1bn**
(2005: £1.0bn)

**NET CASH INFLOW OF £5.0m**
(2005: £4.1m)

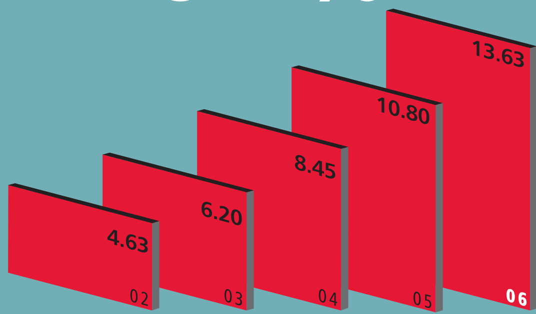
## PROFIT BEFORE TAX* (£m)

# +26.8%



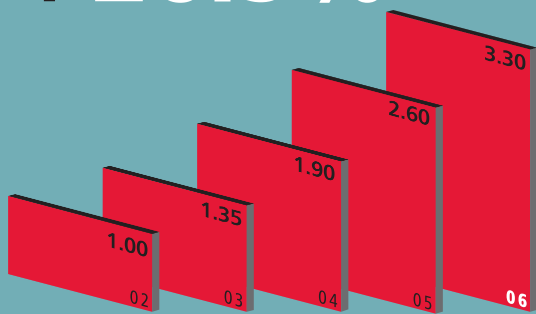

## DILUTED EARNINGS PER SHARE (p)

# +26.2%




## DIVIDEND PER SHARE (p)

# +26.9%




## GROUP TURNOVER (£m)

# +18.6%


* Before share option charges and amortisation.

# OUR BUSINESS

**Our values**

Mears is a community in its own right. What we say and do creates our reputation, as individuals and as an organisation, and this drives our success. We have introduced a set of values to guide us. These help to make us more effective and efficient – and they help to make Mears a great place to work.

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

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

**We value personal responsibility,** setting and achieving consistently high standards in our work and our conduct and never adopting a negative attitude.

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

## Our vision

Our purpose is to make a positive difference to the communities we serve by improving homes, improving neighbourhoods and improving lives.

We do this by constantly striving to achieve the highest levels of customer satisfaction, efficiency and effectiveness.

Our approach is based on the development of outstanding partnerships with employees, clients, tenants and the wider community.

Success enables us to create great opportunities for our employees and sustainable value for our shareholders.

## What we do

Every day our people support clients and tenants by:

- Maintaining and improving homes, buildings and communities.
- Carrying out a planned programme of Decent Homes improvements.
- Fixing damage and responding to other urgent tenant needs.

We work hard to improve people's quality of life wherever we operate.

## How we do it

We listen carefully to people's needs and we always try to find better ways to do things.

We believe tenants should be involved at all stages and always put their needs at the heart of what we do.

We call our approach the Mears Way. Through this we capture the best ideas, processes and methods and share them with colleagues so all stakeholders can understand and follow the right way to do things – every single day.

## Why we do it

Helping our clients to meet their objectives enables us to grow the scale and profitability of our business so as to provide improving service levels.

That means we can create great opportunities for our employees and sustainable value for our shareholders.

Success also enables us to support a wide range of community projects, from breakfast clubs for schoolchildren to skills training centres for potential employees.

## Our market

Social housing is a buoyant market with lots of potential for further growth. We meet the need for both ongoing repairs and maintenance work and the capital works required to upgrade housing to meet the Decent Homes Standard.

All local authorities are required to bring social housing stock up to a decent standard by 2010. A Decent Home is defined as a property that is wind and weather tight, warm and has modern facilities. Central Government is investing around £3.5 billion each year on Decent Homes Standard works and we expect this commitment to last well beyond 2010, probably until 2015.

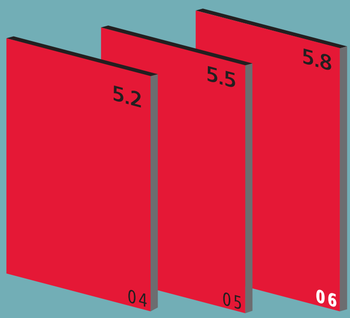
We believe the repairs and maintenance area will provide us with an addressable market of at least £5 billion each year. This market area is growing and the key trend is a move towards larger, longer term contracts. More and more local authority clients want to work with suppliers able to develop and implement innovative partnership models.

We expect the market share of larger service providers to increase in both Decent Homes and repair and maintenance as an increasing number of local authorities, arms-length management organisations and housing associations seek to develop long-term partnerships with a smaller number of providers.

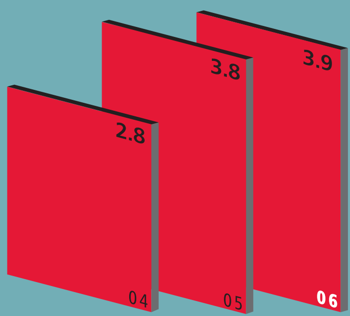
● Mears locations

**OPERATING MARGIN (PRE SHARE-BASED PAYMENTS) (%)**

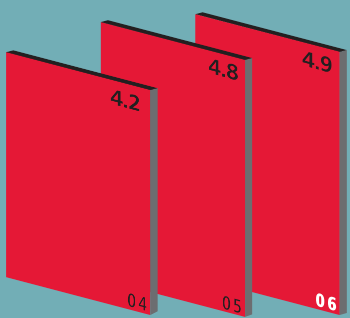
**Social Housing**




**Mechanical and Electrical**




**Vehicle Distribution**




MARGINS INCREASED ACROSS ALL BUSINESS SEGMENTS.

# CHAIRMAN'S STATEMENT

**I am delighted to announce another year of strong growth in profitability and turnover, our eleventh consecutive year of record profits. The acquisition of Careforce Group plc is an expansion of our public sector services into the community domiciliary care provision market. Your Board believes that there is potential to develop the sophistication of the domiciliary care market which has parallels with the way in which Mears has driven the development of the social housing market during the last ten years.**

Mears was listed on the Alternative Investment Market of the London Stock Exchange (AIM) in October 1996. We had 83 employees and turnover of £12m. Since then we have achieved an average annual compound growth rate in profits of 40%.

Throughout 2006 we have continued to build long-term partnership relationships with our customers and are delighted to welcome new customers and new employees into the Group. We are positioned for another stage of our development with a focused management team targeting two growing public sector markets.

We've continued our strong growth this year. In line with current market expectations, turnover was up 18.6%, operating profit before share-based payments and amortisation was up 26.8% and dividend is up 26.9% compared to the previous year. We now employ 2,500 people and we have an order book in excess of £1 billion. It's another very strong, very consistent set of results that are a credit to our employees.

### Consistent qualities

We have been through enormous changes since being listed all those years ago but the same four qualities have remained:

- We are not afraid of hard work.
- We have an open and honest approach to partnership – with clients, with tenants, with suppliers and with advisers.
- We have strong financial management across the entire business.
- We know how to work together effectively.

We have experienced increased competition and despite that we have kept our order book above the £1 billion level which reflects well upon our development team and their insistence upon only bidding on those contracts where our partnership ethos will be valued. We will not compete solely on a price model in our chosen markets. I believe it is the quality of those orders that is most significant. These are long-term relationships with clients based on the right key performance indicators. We have never taken on short-term contracts simply to create more flattering figures. We are building a robust business, a business based on real partnerships, aimed at creating value for money and improving the lives of tenants.

### People: our primary asset

We have continued to recruit from the strong talent available nationally whilst retaining the large majority of our senior team. One of the true measures, in my opinion, of being an employer of choice is that the majority of the senior team at Mears has been with the Group for a period of in excess of six years. Our retention of key employees has been successful and we adopt the same partnership approach to our employees. A recent employee survey indicated that the Group is still very much a fun place to work.

At the end of January 2007 we announced the resignation of Stuart Black. I took on the role of Chief Executive Officer in addition to my existing role as Executive Chairman of the Group and have reduced my outside commitments in order to devote more time to the Group. At the same time we appointed David Miles to the Group Board as Managing Director of Mears Social Housing to bring added depth and insight at the operational level.

I do believe that the strong management teams we have built throughout Mears will demonstrate our resilience to these changes at Group level and I am personally committed to providing those teams with all the resources they require to ensure they take the Group to the next stage of growth.

### Improving communities is part of our DNA

Our community affairs programme, as part of our corporate social responsibility remit, is not just a set of policies here – it is at the heart of this Group. I believe our work should help to improve daily life for people. I say our job is to make tenants smile. Our proposed acquisition of Careforce Group plc brings us ever closer to the community and delivers on our strategy to become the leading provider of outsourced services in the community.

Many of our employees come from the communities they serve and through apprenticeship schemes we are helping to increase employment and opportunity in deprived areas. We are planning to make our workforce even more reflective of our communities.

Our community work has a real effect on people's lives. Throughout the year we have been involved in over 220 community based initiatives which provided a real and tangible benefit to those communities. Our community affairs team voted, as our outstanding initiative, our work at the Russell Gardens sheltered housing development in Stockport. A fantastic demonstration of a local community working with us to create a "better life". Simon Howard from our Broadstairs office was voted Mears Customer Services Champion for services provided above and beyond our measure of service. He was awarded his prize at our annual conference in January 2007, I commend him to you.

### A strong position in great markets

I see excellent prospects in social housing. We continue to see a trend for larger, longer-term contracts and that plays to our strengths as a leader in that market.

We can still maximise our advantages in terms of quality of service, scale, innovation and our proven commitment to working in partnership.

I see no signs that change in the political climate will affect the social housing market significantly. The Decent Homes initiative was scheduled to end in 2010 – though we expect that to stretch to 2015. We are a leader in the strong repairs and maintenance market and see little difficulty in continuing to build our business as Decent Homes comes to an end to be replaced by capital works programmes.

The UK care market, of which domiciliary care represents a significant part, has grown strongly as a result of an increased trend for outsourcing to private sector providers.

The demographics of the UK show that those aged 85 plus are in the fastest growing age group. Government commitments that care should, where possible, be carried out in the home suggest that care provides a further opportunity for long-term growth.

**Looking ahead**
I would like to thank everyone at Mears for their commitment and hard work in 2006. My firm expectation for 2007 is that the excellent team here will raise their game once again. I want everyone within this Group to get the most from the career opportunities they have and to be ambitious for themselves and the business.

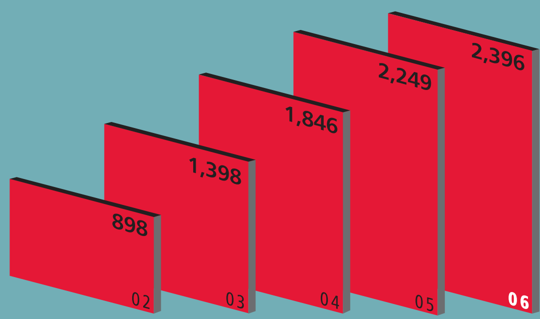
There are enormous opportunities ahead for both our existing business and for the sector we are moving into through the proposed acquisition of Careforce Group plc. I remain absolutely committed to this Group and I am confident that these combined factors will take the Group to new levels in 2007 and beyond.

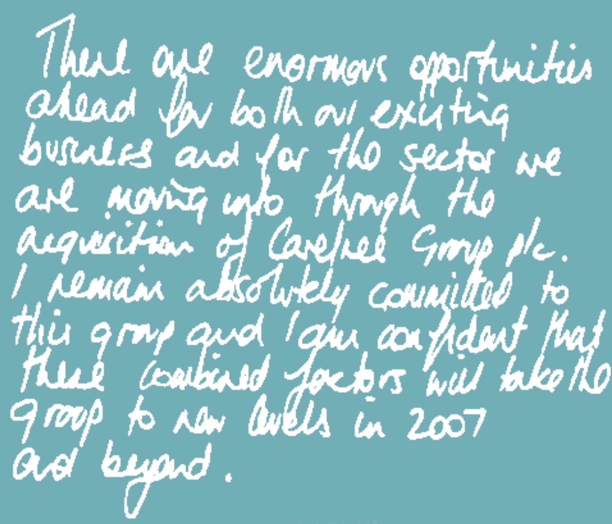
**Bob Holt**
bob.holt@mearsgroup.co.uk
Chairman
7 March 2007

## SUMMARY OF THE CHAIRMAN'S STATEMENT

- An average annual compound growth rate in profits of 40% since 1996.
- Strong prospects for future growth.
- Exciting new opportunity in domiciliary care.
- It is our strategy to become the leading provider of outsourced services in the community.
- Our community affairs programme is at the heart of the Group.

## GROWTH IN AVERAGE EMPLOYEE NUMBERS




# BUSINESS REVIEW

### Turnover
In the year to 31 December 2006 we grew turnover to £241.4m (2005: £203.5m), an increase of 18.6%. Within this overall figure social housing turnover was up 27.7%, reflecting a strong performance in winning new business.

### Operating result
We achieved an operating result before share-based payments and amortisation of £13.0m (2005: £10.3m), a 26.8% increase. The Group managed to increase its operating margin from 5.1% in 2005 to 5.4% in 2006 despite the rapid increase in turnover and we continue to invest in our infrastructure ahead of the projected organic growth. We have had a significant overhaul of our information technology platform which has helped to enhance further the financial control throughout the business.

We have also retained more work on Decent Homes in-house, where Haydon, our mechanical and electrical division, has performed heating works at a number of branches.

### Amortisation
A charge of £0.3m arose in 2006. This represents the write down of the identified intangible assets acquired on the acquisition of Laidlaw Scott Limited in June 2006. The excess of purchase price over the fair value of net assets is capitalised as goodwill and under International Financial Reporting Standards (IFRS) is not amortised but will be subject to an annual impairment review.

### Share-based payments
The share-based payment charge in 2006 was £0.5m, unchanged from 2005. There is no cash impact from this new expense which arose from the adoption of IFRS in 2005.

### Finance
The Group again maintained its broadly neutral cash position throughout the 12 months to 31 December 2006 and achieved a net interest receipt of £0.01m (2005: payment £0.02m). The Group’s focus on tight working capital control remains a cornerstone of our offering given the tremendous scale of growth being generated.

### Tax expense
£2.1m has been provided for a tax charge (2005: £2.5m). The effective rate in 2006 of 17.0% (2005: 27.4%) is low due to the impact of a corporation tax deduction received on the exercise of share options.

### Earnings per share (EPS)
Basic EPS increased 37.5% to 17.05p (2005: 12.40p). Our diluted EPS of 15.99p was up 39.7% on the comparative 2005 figure of 11.45p. All figures are stated after the impact of share-based payments. If a full tax rate of 30% is applied to the pre amortisation result the diluted EPS for 2006 rises to 13.63p (2005: 10.80p), a 26.2% uplift.

**EVERY DAY WE CARRY OUT**

**1,750**

**repairs**

**Dividend**

The dividend increase is in line with our earnings growth. A final dividend of 2.4p per share is proposed which combined with the 0.9p interim dividend gives a total dividend of 3.3p per share (2005: 2.6p). In accordance with IFRS, the final dividend has not been recognised within the Group financial statements as it did not represent an obligation at the balance sheet date.

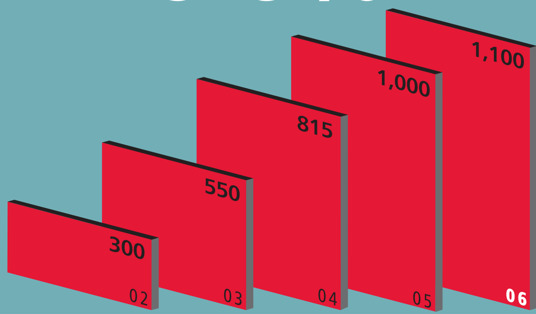
The dividend is payable on 2 July 2007 to shareholders on the register on 15 June 2007.

**SUMMARY OF THE BUSINESS REVIEW**

- Order book of £1.1 billion.
- Award winning performance including being named Partnering Contractor of the Year.
- Social Housing turnover up 27.7%.
- A net cash inflow of £5.0m converting 101.5% of operating profit into operating cash flow.

**ORDER BOOK GROWTH (£m)**

**+10.0%**




We have had a significant overhaul of our information technology platform which has helped to enhance further the financial control throughout the business.

# BUSINESS REVIEW

### Cash flow
The cash flow position continues to underline our strength as a business. A net cash inflow of £5.0m was achieved in 2006 (2005: £4.1m inflow). The Group converted 101.5% of operating profit into operating cash flow (2005: 109.2%). Some £2.2m was used to acquire the business of Laidlaw Scott Limited and £1.4m was absorbed on the settlement of deferred consideration on previous acquisitions.

A further £1.6m was invested in new technology and operational bases. The Group benefited from the exercise of options in 2006 by some £1.6m. Our net cash position at 31 December 2006 was £11.9m, up from £6.9m at the start of the year.

### Acquisition
The acquisition of the entire share capital of Laidlaw Scott Limited was settled with an initial payment of £2.2m (including costs) for net assets of £0.2m plus an additional payment of up to £2.8m subject to future performance to 31 December 2007. The business was substantially debt free and generated a profit before tax of £0.4m on a turnover of £6.0m in the year to 31 August 2005. Post acquisition Laidlaw Scott returned a pre-tax result of £0.3m on turnover of £4.2m. The business is performing in line with our expectations and as a result of this acquisition we are now pursuing a number of tender opportunities in Scotland.

We continue to seek out quality businesses with the potential to help us further our strategic objectives and improve or broaden our services. While we monitor opportunities to acquire a business in Wales, we continue to develop organic growth opportunities in the area.

### Order book
The visibility of our earnings continues to improve. £222m of new social housing work was secured in 2006 from 15 customers. Our order book now stands at £1.1 billion (2005: £1.0 billion). The element of market forecast turnover secured for 2007 is 90%, with an additional 4% due from transactional business and also 69% of the 2008 market forecast, with an additional 15% from transactional business. We continue to place great emphasis on winning good quality contracts that can provide clear and sustainable margins. We also hold a healthy mix of Decent Homes and repairs and maintenance work, giving us a balanced position in the social housing market that is not reliant on clients' future discretionary spending.

### Total equity
Total shareholders' equity value rose by £9.9m in 2006 from £28.1m to £38.0m at 31 December 2006.

### Key developments and achievements
#### Mobilised contracts
Over the last 12 months the following key contracts have come on-stream. These are:

- London Borough of Greenwich, five-year Decent Homes contract.
- Portsmouth City Council, three-year repair and maintenance contract.
- Kensington Housing Trust, five-year repair and void maintenance contract.
- London Borough of Kingston upon Thames, seven-year repair and void maintenance contract.
- Maidstone Housing Trust – A five-year repair and maintenance contract.
- Nottingham City Homes, five-year Decent Homes contract.
- GM Procure – We have been appointed as a primary contractor partner with GM Procure to deliver Decent Homes services to authorities in the North West. Again we believe our existing contract with Stockport Metropolitan Borough Council has been instrumental in securing this work.
- Cross Keys Homes in Peterborough – We have secured a contract with an existing customer to provide the cyclical decorating for a period of seven years.

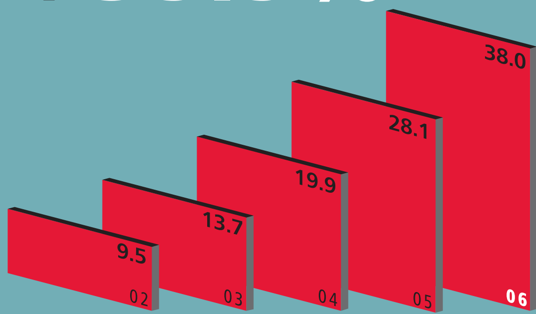
### Major contract wins
In addition to the mobilised contracts we have also achieved a number of major successes, winning social housing contracts valued at £222m in total over the last year. Highlights included:

- Ealing Homes – The addition of a new Decent Homes contract to add to our existing repairs and maintenance contract. We are one of the client's core partners and believe we are in a strong position to gain a significant share. Our client has already secured funding of £205m with potential for further additional funding.
- Orbit Homes – A five-year repair and maintenance contract.
- Twynham Housing Association in Dorset and Hampshire – A two-year repair and void maintenance contract.
- Town and Country Housing Association in Kent and Sussex – We have secured a new five-year Decent Homes contract.

- Cross Keys Homes in Peterborough – We have secured a contract with an existing customer to provide the gas maintenance for a period of five years.
- Brighton and Hove City Council – A five-year repair and void maintenance contract.
- Shoreline Housing Association – A four-year gas maintenance contract.
- Watford Council – A three-year gas maintenance contract.

**NET ASSETS (£m)**

**+35.5%**




*We continue to place great emphasis on winning good quality contracts that can provide clear and sustainable margins.*

# BUSINESS REVIEW

### Awards

We are delighted that during the year we have received several awards recognising our commitment to customers, staff and investors:

- Mears was awarded TPAS (Tenant Participation Advisory Service) Quality Standard Mark, which assesses the quality of resident involvement with contractors, tenants and landlords. This is the first time TPAS has awarded its quality mark to a supplier or contractor.
- We were awarded 'Partnering Contractor of the Year' at the UK Housing Excellence Awards.
- Mears and Richmond Housing Partnership won the 'Making Partnerships Work' award at the London Excellence Awards.
- The Group achieved Age Positive Employer Champion status from the Department of Work and Pensions.
- Mears was awarded Occupational Health and Safety Gold Award from RoSPA.
- At the South West Financial and Corporate Communications Awards we were successful in the following categories:
  - 'Company of the Year'.
  - 'Best Commitment to Environmental and Social Responsibility'.
  - 'Best Communicators of the Year'.

We believe we are well placed to continue delivering on 'improving homes, improving neighbourhoods, improving lives'.

### Training and development of staff

We are an established Investor in People and we are meeting the challenge of the skills shortage in our sector through a comprehensive national programme of employee development, together with structured work experience and training programmes for existing and prospective employees.

This year we have been taking our trade professionals through a skills-based NVQ programme and we have developed a unique Mears Professional Development Customer and Community Care NVQ to further raise our customer service standards.

### Operational expertise

The Mears Way committee is headed by senior management from within the Group and is responsible for developing and documenting best practice and ensuring that we use the benefits of scale without losing local focus. This includes our approach to the procurement of materials through to the delivery of customer service. The main focus in 2006 was best practice customer care. The fact that we are now achieving record levels of customer satisfaction across our business is a testament to that group's success.

The overhaul of our core operational system, MCM, has given we believe the best system of its kind in the market. It has modules both for response repairs and for Decent Homes work.

### WESTERN SKILLS CENTRE

The Western Skills Centre was opened by the Minister of Trade and Industry, Ian McCartney MP, in the summer of 2006.

This is a unique collaboration between five Wigan high schools, Wigan Education Business Partnership and Mears.

Over 100 children per week go to the centre and experience courses in bricklaying, painting and decorating and joinery.

"The Skills Centre team had no construction/ trade experience, therefore the expert advice Mears provided throughout the development of the project proved invaluable."

**Mr Phillips, Head Teacher**
St Edmund Arrowsmith High School

We are expanding the use of hand held technology across an increasing number of contracts and our new management Key Performance Indicator dashboard, enables real time analysis of performance across all branches.

**Customer and community care**

With 40% of our staff participating in community improvement projects, Mears now has one of the highest levels of volunteering of any company of its size in the UK. Over 12,000 hours of community work was undertaken with 220 projects supported, double that of the levels in 2005.

It is by building strong community links that Mears improves its overall service levels, gets to understand customer needs better and brings all staff into direct contact with the community they are serving.

The CSR section of this annual report provides more detail around our work but given the Government strategic shift from Decent Homes alone, to one of developing sustainable communities, Mears is very well placed to benefit from this change.

**Outlook**

Our order book is at record levels with a very healthy new business pipeline.

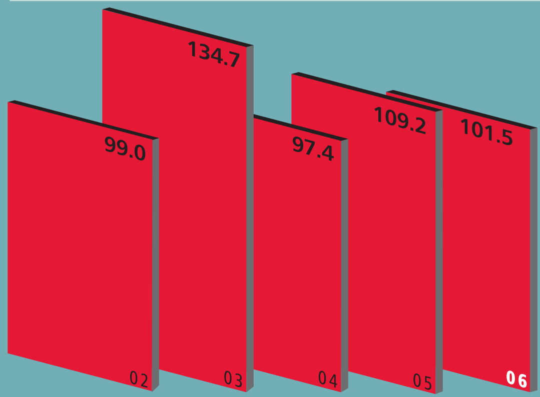
Government policy, which both embraces investment in communities and ongoing public private sector partnership, continues to generate new opportunities.

Our investment in people, IT and operational best practice ensures we have the capability to make the most of the growth opportunity.

**Bob Holt**
bob.holt@mearsgroup.co.uk
Chairman
7 March 2007

**David Robertson**
david.robertson@mearsgroup.co.uk
Finance Director
7 March 2007

**CONVERSION OF OPERATING PROFIT INTO CASH (%)**




It is by building strong community links that Mears improves its overall service levels, gets to understand customer needs better and brings all staff into direct contact with the community they are serving.

# CORPORATE SOCIAL RESPONSIBILITY

**Our communities**
We work in some of the most socially deprived areas of the country. Along with our professional commitment to tenants, we feel a strong sense of responsibility towards the wider community and we work towards achieving three specific aims:

- To support and strengthen the communities in which we work.
- To recruit employees locally whenever we can.
- To encourage employees to volunteer their time and skills to specific community projects.

Helping a local community to thrive increases the quality of life for tenants and makes our job that little bit easier. It is also rewarding for our employees, especially as 90% of our people live in the community they support. Given the Government's interest in promoting sustainable communities, our work here is increasingly important in developing our business.

In 2006 our staff delivered over 12,000 hours of community work (double 2005) with 40% of staff actively volunteering. We supported upwards of 220 different projects.

Many people were helped:

- 40 schools have received direct support from us.
- 36 community centres, day centres and hospices have had their facilities improved with two actually being kept open by our support.
- 220 children have had their reading skills improved.
- 500 children have received information on safety at home.
- 1,140 people in homeless centres have had their facilities improved.
- 150 people have been given work experience and/or taken part in one of our apprenticeship schemes.
- 22 communities have been improved through the removal of graffiti and the provision of alternative activities for youngsters.
- £120,000 of fund raising has helped 60 different charities, especially Shelter.

Four examples of our work include:

**The Western Skills Training Centre in Wigan**
A partnership with five schools where youngsters are given direct training on key trades as a part of their schools studies. This has given many young people the opportunity to consider going onto formal trade qualifications.

**Improvements to the Accident and Emergency area of Peterborough hospital**
Mears staff provided both the materials and the people to refurbish the Accident and Emergency waiting area. Enough money was therefore saved to allow the hospital to purchase another baby monitoring unit.

**St Luke's in Wakefield**
Our work here has included supporting the refurbishment of an old school building together with the renovation and building of a media centre aimed at all age groups.

**Russell Gardens in Stockport**
This sheltered housing development was in danger of closure due to its poor condition. Mears staff completely redeveloped the gardens, improving the well-being of the residents. This has helped keep the centre open for the benefit of all the residents.

We have also launched the Mears "Future Champions" project. This provides both financial and work placement support to young, talented athletes from communities in which we work. We hope to see some of these youngsters develop towards London 2012.

**THE MEARS FUTURE CHAMPIONS PROJECT PROVIDES BOTH FINANCIAL ASSISTANCE AND WORK EXPERIENCE TO GIFTED YOUNGSTERS FROM COMMUNITIES IN WHICH WE WORK.**

**WE ARE CURRENTLY SUPPORTING FIVE YOUNG ATHLETES, HELPING THEM PROGRESS MORE RAPIDLY TOWARDS THEIR FUTURE GOAL FOR SPORTING SUCCESS, PARTICULARLY WITH LONDON 2012 IN MIND.**

**SUMMARY OF THE CSR REPORT**

- Over 220 community improvement projects completed.
- One of the highest staff volunteering rates in the UK.
- Launch of Mears Future Champions project in support of 2012 and beyond.
- Commitment to being carbon neutral by end of 2007.
- Increasing support for training, work experience and apprenticeships.

**Supporting good causes**

Our commitment to the community is recognised in Mears attaining the Business in the Community 'Percent Standard'. This benchmark measures the contributions made by companies through cash donations, staff time, gifts in kind and management time, calculated as a percentage of pre-tax profit. The Percent Club recognises those companies who put the equivalent of at least 1% of their pre-tax profit into community work. In 2006 Mears invested 4% of its profits in community work through volunteering time, materials and cash donations.

I think that the Tenants Surgeries organised by Mears are extremely good. The feedback that I get from attending tenants is first rate and they really appreciate the surgeries. Also, all the CSR work that Mears Welwyn and Hatfield carries out is excellent.

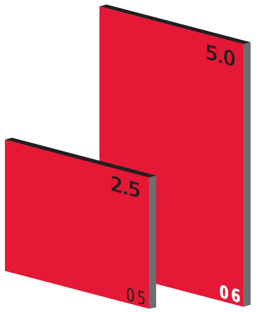
**Denis Hedges**
Chairman Tenants Panel, Welwyn and Hatfield

# CORPORATE SOCIAL RESPONSIBILITY

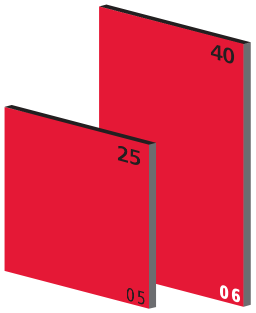
**40% OF MEARS STAFF TOOK PART IN VOLUNTEERING WORK IN THE LOCAL COMMUNITY IN 2006.**

**STAFF USE THEIR SKILLS, WHETHER THESE BE TRADE SKILLS OR OFFICE SKILLS, TO PROVIDE REAL SUPPORT TO LOCAL COMMUNITY PROJECTS THAT HAVE BEEN SELECTED BY RESIDENTS OF THE COMMUNITIES IN WHICH WE WORK.**

**Community hours per employee**




**% of employees that do community work**




## Our communities continued

### Supporting good causes continued

We partnered with the charity Shelter in the year. They share our values in terms of wanting to improve both the quality of housing and the sustainability of communities. £100,000 was raised for Shelter. Five youngsters who hold regional, national and international records from a range of sports are also being supported.

## Our workplace

We want to become a recognised 'Employer of Choice' within our sector with a workforce that fully reflects the communities we serve. To help us achieve this, we have three key aims:

- To develop a culture of good communication and trust within the business, so every employee shares the same values and works towards the same business objectives.
- To manage change in a fast-growing, high-performance organisation by anticipating the people and resources we will need well before they are needed.
- To encourage our employees to work together effectively in all situations.

### Training and development

We're now an established Investor in People, retaining the award in 2006 and we're meeting the challenge of the skills shortage in our sector through a comprehensive national programme of employee development, together with structured work experience and training programmes for existing and prospective employees.

This year we have invested £300 per employee in training which includes:

- Starting to take all our trades professionals through a skills-based NVQ programme.
- The development of a unique Mears Professional Development Customer and Community Care NVQ, to help raise our customer service standards even higher.

### Culture and diversity

For us diversity is about having a group of employees who reflect the community they serve. It is about having the right blend of age, sex, race and cultural background required to understand the needs of the people we support. We operate in a sector that has been very male-orientated for many years, but we are addressing that imbalance. Women now have roles within Mears from executive director to apprentice, but we have more work to do in this area. We will continue to address the issues involved and support the Women in Construction programme. We also achieved the Age Positive award in 2006, demonstrating our fair approach across all age groups.

### Support for employees

We continue to provide a free 24 hour, 365 days per year confidential helpline called Mears Assist. This provides employees with advice on a wide range of personal and work-related matters and is available to their immediate families. We see Mears as a community in its own right and initiatives such as this are intended to help people get the most from their life while working here.

## Our market

We are a market leader in the social housing sector and we believe we have a responsibility to help improve knowledge, understanding and the overall performance of our market.

In particular, we set out:

- To find and work with partners who share our values.
- To help clients and other organisations meet and learn from one another.
- To look for innovative ways to improve efficiency and effectiveness – for the benefit of clients, tenants, local communities and tax payers.

### Thought leadership

We have run and published our third Thought Leader report on the subject of Sustainable Communities.

We ran this with support from the Chartered Institute of Housing, the Tenant Participation Advisory Service and Shelter. Professionals from the Housing industry debated how to deliver real community improvements effectively. The report is available from our website.

Our most recent event was in Glasgow, helping to build links for Mears in the Scottish marketplace.

### Procurement policies

We have now developed a clear set of principles for our suppliers covering the CSR agenda. We also brought 17 of our top suppliers together to discuss how we could more pro-actively involve them in our community improvement activities.

## Our environment

We take our environmental performance very seriously and work continuously to improve our practices. Our aims are:

- To have a positive effect where we work, always trying to improve a neighbourhood.
- To minimise waste and follow good environmental practice throughout the business, from our work in people's homes and neighbourhoods to the way we run our offices.

We have achieved the ISO 14001 standard in some of our branches and are rolling out this standard to other parts of the Group. As a part of this we are significantly improving the level of waste we recycle. In 2006, 40% of our waste was recycled and we expect this to grow further in 2007.

Mears is working with the Carbon and Energy Saving Trusts to carry out surveys on our premises with a view to reducing our own and our clients' carbon footprints through monitoring our activities and investing in new environmental initiatives, technology and research.

We are also working hard to increase environmental awareness for all our staff. We have trained many of our Customer and Community Care Officers in a City and Guilds energy advice qualification. This enables these staff to provide practical advice to tenants on how they can improve the environmental efficiency of their homes and also save some money.

I am a lady of 80 years who lives alone. I am delighted to say Mears always gives me the best repair service. Being very active in the community I am very grateful for the help, encouragement and information given by Mears' Customer Care Manager.

**Mrs Bird**
Southall

### Health and safety

We are proud to continue to hold the RoSPA Gold Health and Safety Award. In 2006 we reduced our Accident Incident rate again, as we have done year on year. Mears substantially increased its Safety, Health and Environmental (SHE) training over 2006 and recruited a new Group Health and Safety Director. In partnership with the British Safety Council, Mears has developed a Group specific accredited SHE course which will be rolled out during 2007 to all our current and future employees. This is the first time that the British Safety Council has worked with a company to produce such a course.

# BOARD OF DIRECTORS

**Robert Holt (51)**
Chairman and Chief Executive
Bob acquired a controlling interest in Mears prior to flotation in October 1996. He has a background in developing support service businesses. He has operated in the service sector since 1981 initially in a financial capacity then moving into general management. He is a member of the Audit Committee.

**David J Robertson (50)**
Finance Director
After attending Edinburgh University, David qualified as a Scottish Chartered Accountant in 1979. He spent time in Imperial Tobacco and Lloyds Bank before joining MITIE Group PLC in 1991, where he was Finance Director of MITIE Cleaning for over six years during a period of rapid expansion. He joined the Group in 1997 as Finance Director.

**David J Miles (41)**
Managing Director of Mears Social Housing
David joined Mears in May 1996 and prior to his appointment to the Board in January 2007 was Managing Director of Mears Southern Social Housing Division. Prior to joining Mears, David held a senior position with MITIE Maintenance (South East) Limited. His background is electrical engineering.

**Andrew C M Smith (34)**
Executive Director
Andrew joined Mears in December 1999 and prior to his appointment to the Board was Finance Director covering all the Mears Group's subsidiaries. Andrew qualified as a Chartered Accountant in 1994 and prior to joining Mears he worked as an auditor with Grant Thornton.

**Michael Rogers (64)**
Executive Director of Mears Care Division
Michael founded Careforce in 1999 and has over 30 years' experience in healthcare services and care provision. In 1976 he joined Nestor Medical Group Limited as Managing Director and went on to become Chief Executive of Nestor Healthcare Group plc from 1986 to 1996. From 1996 to 1999 he worked as a consultant to a number of healthcare related organisations.

**Michael A Macario (68)**
Senior Independent Non-Executive Director
Michael is a Chartered Accountant and a Director of a number of companies. He joined Mears in 1996 upon flotation and is Chairman of the Group's Audit Committee.

**Reginald B Pomphrett (62)**
Company Secretary and Non-Executive Director
Reg has been involved in corporate finance for over 30 years and is Director of a number of companies. He is a Chartered Secretary and a member of the Securities Institute. He joined Mears in 1996 and is Chairman of the Group's Remuneration Committee.

# SHAREHOLDER AND CORPORATE INFORMATION

**Internet**
The Group operates a website which can be found at www.mearsgroup.co.uk. This site is regularly updated to provide information about the Group. In particular all of the Group's press releases and announcements can be found on the site.

**Registrar**
Any enquiries concerning your shareholding should be addressed to the Company's Registrar. The Registrar should be notified promptly of any change in a shareholder's address or other details.

**Investor relations**
For further copies of the annual report and accounts or other investor relations enquiries, should be addressed to the registered office.

**Registered office**
1390 Montpellier Court
Gloucester Business Park
Brockworth
Gloucester GL3 4AH
Tel: 01453 511 911
www.mearsgroup.co.uk

**Company registration number**
3232863

**Bankers**
Barclays Bank
18 Southgate Street
Gloucester GL1 2DJ
Tel: 01452 365353

**Solicitors**
BPE
St James's House
St James' Square
Cheltenham GL50 3PR
Tel: 01242 224433

**Auditors**
Grant Thornton
Registered Auditors
Chartered Accountants
The Quadrangle
Imperial Square
Cheltenham GL50 1PZ
Tel: 0845 026 1250

**Nominated adviser and stockbroker**
Investec Investment Banking
2 Gresham Street
London EC2V 7QP
Tel: 020 7597 2000

**Financial adviser and stockbroker**
Arbuthnot
Arbuthnot House
20 Ropemaker Street
London EC2Y 9AR
Tel: 020 7012 2000

**Advisers**
Zeus Capital
3 Ralli Courts
West Riverside
Manchester M3 5FT
Tel: 0161 831 1512

**Registrar**
Neville Registrars
Neville House
18 Laurel Lane
Halesowen
West Midlands B63 3DA
Tel: 0121 585 1131

# FINANCIAL CALENDAR

| | |
|---|---|
| Annual General Meeting | 6 June 2007 |
| Record date for final dividend | 15 June 2007 |
| Dividend warrants posted to shareholders | 2 July 2007 |
| Interim results announced | 21 August 2007 |

# REPORT OF THE DIRECTORS

The Directors present their report together with the consolidated financial statements for the year ended 31 December 2006.

## Principal activities

The principal activities of the Group are the provision of a range of outsourced services to the public and private sectors including the provision of maintenance services to social housing landlords, mechanical and electrical building services and the distribution of motor vehicles. The principal activity of the Company is to act as a holding company.

## Business review

An overall review of the business is given in the Chairman's statement and Business Review.

The consolidated profit for the year after taxation and minority interests amounted to £10.2m (2005: £7.2m).

The Directors recommend dividends absorbing £2.0m (2005: £1.5m). The final dividend of 2.40p per share has not been included within the Group financial statements as no obligation existed at 31 December 2006.

## Key Performance Indicators (KPIs)

We operate a balanced scorecard approach. This ensures that the Group targets its resources around its customers, community, employees, operations and finance. This enables the business to be operated on a balanced basis with due regard for all stakeholders.

The primary KPIs used by the Group are:

| | **2006** | 2005 |
|---|---|---|
| Social Housing sales growth | **27.7%** | 38.4% |
| Social Housing operating margin | **5.8%** | 5.5% |
| Operating profit cash conversion | **101.5%** | 109.2% |
| Normalised diluted earnings per share | **13.63p** | 10.80p |
| Community hours per employee | **5** | 2.5 |
| % of employees that do community work | **40%** | 25% |

The Group has continued to develop its contract management system a number of other secondary KPIs are monitored on a real time basis through what is known internally as the Digital Key Performance Indicator Dashboard.

## Directors

The present membership of the Board is set out below. M A Macario and R B Pomphrett retire by rotation and, being eligible, offer themselves for re-election. D J Miles retires having been appointed since the last AGM and offers himself for re-election.

The beneficial interests of the Directors in the shares of the Company at 31 December 2006 and 31 December 2005 are detailed below. The Directors' emoluments are detailed on page 22.

| | Ordinary shares | |
|---|---|---|
| | **31 December 2006 Number** | 31 December 2005 Number |
| R Holt | **500,000** | 500,000 |
| D J Robertson | — | 100,000 |
| M A Macario | **100,000** | 200,000 |
| R B Pomphrett | **150,000** | 200,000 |
| D J Miles | **100,000** | 100,000 |

S J Black resigned as a Director on 23 February 2006.

No Director had, during or at the end of the year, a material interest in any contract which was significant in relation to the Group's business.

The Company has granted options to Directors. Details of these options are given in note 5 to the Group financial statements.

### Directors' responsibilities for the financial statements
The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and IFRS as adopted by the European Union in respect of the Group and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) for the Company.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

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

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

In so far as the Directors are aware:

- there is no relevant audit information of which the Company's auditors are unaware; and
- the Directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

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

### Financial risk management
Risk is an accepted part of doing business. The Group's financial risk management is based upon sound economic objectives and good corporate practice. The Board has overall responsibility for risk management and internal control within the context of achieving the Group's objectives. Our process for identifying and managing risks is set out in more detail on page 22 within the Corporate Governance Statement. The key risks and mitigating factors are set out below.

The Group seeks to manage financial risk, to ensure sufficient liquidity is available to meet the identifiable needs of the Group and to invest cash assets safely and profitably. Short term flexibility is achieved through the use of the bank overdraft facilities.

The Group does not undertake any trading activity in financial instruments. All activities are transacted in Sterling. The Group does not engage in any hedging activities.

The Group reviews the credit quality of customers and limits credit exposures accordingly. All trade receivables are subject to credit risk exposure. However there is no specific concentration of credit risk as the amounts recognised represent a large number of receivables from various customers. The credit risk on trade receivables within the Mechanical and Electrical division is insured. The credit risk on trade receivables in other divisions is not insured due to the secure nature of the customer base.

### Payment policy
The Company acts purely as a holding company and as such is non-trading. Accordingly no payment policy has been defined. However, the policy for Group trading companies is to set the terms of payment with suppliers when entering into a transaction and to ensure suppliers are aware of these terms. Group trade creditors during the year amounted to 44 days (2005: 42 days) of average supplies for the year.

### Substantial shareholdings
On 1 March 2007 the Company has been notified of, or is aware of, the following shareholders holding 3% or more of the issued share capital of the Company:

| | Number of ordinary shares (m) | Percentage of issued ordinary shares % |
|---|---|---|
| Standard Life Investment Management | 7.10 | 11.53 |
| AEGON Asset Management UK | 6.12 | 9.93 |
| Rathbone | 2.25 | 3.66 |
| Columbia Wagner Asset Management | 2.22 | 3.61 |
| Old Mutual Asset Management | 2.17 | 3.52 |
| Wellington Management US | 1.96 | 3.18 |

The Group actively encourages wider share ownership by its employees and the Group's Save As You Earn (SAYE) share schemes have been well received.

# REPORT OF THE DIRECTORS

## Charitable donations

During the year the Group made charitable donations of £0.05m (2005: £0.03m). Further details relating to the Group's commitment to the community and good causes are detailed in the Corporate Social Responsibility Report.

## Disabled employees

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

## Employee information and consultation

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

The Group carried out a confidential employee survey during the year. The survey results were communicated to all employees. The Group has attempted to resolve a number of the issues raised. It is anticipated that a further survey will be carried out in the coming year.

The Group operates a stakeholder pension plan available to all employees. The Group operates a personal pension plan and contributes to the pension schemes of certain Directors and senior employees. The Group also contributes to defined benefit schemes on behalf of a number of employees. The Group operates a SAYE scheme, an Executive Share Option Scheme and an Enterprise Management Incentive Scheme.

## CREST

Mears Group PLC share dealings have been settled on CREST since 1997. CREST is the computerised system for the settlement of share dealings on the London Stock Exchange. CREST reduces the amount of documentation required and also makes the trading of shares faster and more secure. CREST enables shares to be held in an electronic form instead of the traditional share certificates. CREST is voluntary and shareholders can keep their share certificates if they wish. This may be preferable for shareholders who do not trade in shares on a frequent basis.

## Auditors

Grant Thornton UK LLP, who have been the Group's auditors since 1994, offer themselves for re-appointment as auditors in accordance with Section 385 of the Companies Act 1985.

On behalf of the Board

**R B Pomphrett**
Director and Secretary
7 March 2007

# CORPORATE GOVERNANCE

## Introduction

The Board is committed to achieving good standards of corporate governance, integrity and business ethics for all activities.

## Board of Directors

The Board of Directors comprises three Executive Directors and two Non-Executive Directors. The Non-Executive Directors are considered by the Board to be independent of management and free from any relationship which might materially interfere with the exercise of independent judgement. The Board does not consider the Non-Executive Directors' shareholdings to impinge on their independence. The Non-Executive Directors provide a strong independent element to the Board and bring experience at a senior level of business operations and strategy.

M A Macario is the Senior Independent Non-Executive Director.

All Directors have access to the Company Secretary who is responsible for ensuring that Board procedures and applicable rules and regulations are observed. Any Director, on appointment and throughout their service, is entitled to receive any training they consider necessary to fulfil their responsibilities effectively.

The Board meets regularly throughout the year as well as on an ad hoc basis, as required by time critical business needs. They also meet on a regular basis with Directors of the subsidiary companies. This forum provides the principal format for directing the business of the Group.

## Board Committees

The Board has delegated authority to three Committees. The Chairman of each Committee provides a report of any meeting of that Committee at the next Board meeting. The Chairmen of each Committee are present at the Annual General Meeting to answer questions from shareholders. Brief details are set out below:

### Audit Committee

The Audit Committee comprises R B Pomphrett and M A Macario, its Chairman. The purpose of the Committee is to ensure the preservation of good financial practices throughout the Group; to monitor that controls are in force to ensure integrity of financial information; to review the interim and annual financial statements; and to ensure compliance with accounting standards and generally accepted accounting principles.

In addition, the fees and objectivity of the Group's auditors are considered by the Committee. Detailed presentations to the Committee are made by the Group's auditors. The presence of other senior Executives from the Group may be requested.

### Remuneration Committee

The Remuneration Committee comprises M A Macario and R B Pomphrett, its Chairman. The Committee is responsible for the Executive Directors' remuneration and other benefits and terms of employment, including performance related bonuses and share options.

### Nomination Committee

The Nomination Committee comprises R B Pomphrett, M A Macario and R Holt. The Committee meets twice a year and is responsible for succession planning within the Group and for the recommendation of appointments to the Board for Executive and Non-Executive Directors.

## Meeting attendance

All Directors are encouraged to attend all Board meetings and meetings of Committees of which they are members.

Directors' attendance at Board meetings and Committee meetings during 2006 is shown in the following table:

| | Board | Audit Committee | Nomination Committee | Remuneration Committee |
|---|---|---|---|---|
| Number of meetings | 6 | 2 | 2 | 1 |
| R Holt | 6 | — | 2 | — |
| S J Black | 6 | — | — | — |
| D J Robertson | 6 | — | — | — |
| M A Macario | 6 | 2 | 2 | 1 |
| R B Pomphrett | 6 | 2 | 2 | 1 |

## The Company and its shareholders

The Board remains committed to ongoing dialogue with its shareholders. This commitment was recognised by the AIM Best Communications Award in 2001 and 2004 and AIM Company of the Year Award in 2003. The Group has continued to increase its awareness to the investing public at large and is represented at a series of Investor Relations exhibitions, where shareholders have welcomed the opportunity to both meet the management team and improve their understanding of the Group.

The principal methods of communication with private investors remain the annual report and accounts, the interim statement, the Annual General Meeting, the quarterly newsletters and the Group's website (www.mearsgroup.co.uk).

# CORPORATE GOVERNANCE

### Internal control and risk management

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. Such systems are designed to manage rather than eliminate risks and can only provide reasonable and not absolute assurance against misstatement or loss.

The Group has established procedures for all business units to operate appropriate and effective risk management. They place clear responsibility for risk management and the Group endeavours to ensure that the appropriate controls, systems and training are in place.

The Group has also established procedures to routinely test internal control systems. The Board has reviewed these procedures and considers them appropriate given the nature of the Group's operations.

A comprehensive budgetary process is completed on a quarterly basis and is reviewed and approved by the Board. The Group's results as compared to both the budget and prior year are reported to the Board on a monthly basis, with remedial action taken when appropriate.

The Board routinely reviews the effectiveness of the system of internal control and risk management to ensure controls react to changes in the Group's overall risk profile.

The Group maintains appropriate insurance cover and reviews the adequacy of the cover regularly.

There are clearly defined procedures for reviewing and approving all bids, acquisitions and capital expenditure within the Group.

### Remuneration policy

The remuneration policy is set by the Remuneration Committee and is designed to deliver the Group's objectives of creating real increases in shareholder value by attracting and retaining the most capable and committed people. Individual remuneration packages are determined by the Board within the framework of the following policy.

The Directors' remuneration packages comprise the following components:

- annual salary and fees – the actual salary for each of the Executive Directors is determined by the Remuneration Committee; these salaries reflect experience and sustained performance of the individuals to whom they apply, also taking into account market competitiveness;
- annual incentive payments – the Executive Directors are entitled to bonuses related to the real increase in earnings per share together with the achievement of other internal targets. In addition the grant of share options is supervised by the Remuneration Committee which also determines whether any performance targets will apply to the grant and/or exercise of options;
- benefits in kind – such as car and health benefits; and
- defined contribution pension schemes.

The Directors' emoluments in 2006 are detailed below:

| | Annual salary and fees | | Annual incentive payments | | Benefits in kind and other emoluments | | Total | |
|---|---|---|---|---|---|---|---|---|
| | **2006 £'000** | 2005 £'000 | **2006 £'000** | 2005 £'000 | **2006 £'000** | 2005 £'000 | **2006 £'000** | 2005 £'000 |
| R Holt | **250** | 250 | **—** | 85 | **107** | 109 | **357** | 444 |
| S J Black | **200** | 200 | **—** | 51 | **33** | 27 | **233** | 278 |
| D J Robertson | **175** | 165 | **—** | 56 | **43** | 42 | **218** | 263 |
| M A Macario | **35** | 24 | **—** | — | **—** | — | **35** | 24 |
| R B Pomphrett | **35** | 24 | **—** | — | **1** | — | **36** | 24 |
| | **695** | 663 | **—** | 192 | **184** | 178 | **879** | 1,033 |

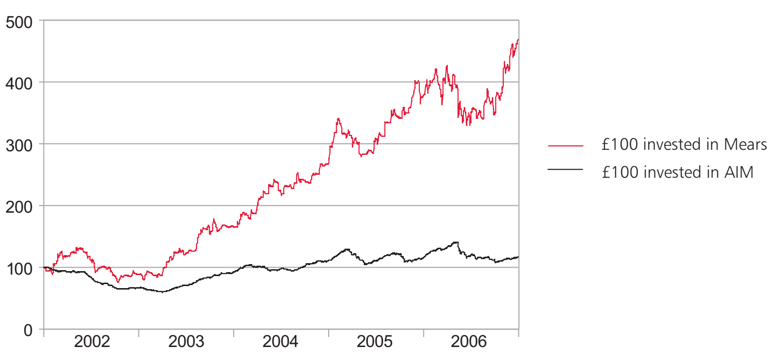
Details of share options issued to Directors are included within note 5 to the Group financial statements.

The Managing Directors of the operating subsidiaries are rewarded by basic salaries and bonuses determined by the achievement of exceeding performance targets for their individual business units. The value of overdue work in progress and debtors is taken into account in arriving at profit for bonus purposes.

All employees are eligible to participate in one or more of the share incentive arrangements operated by the Group.

### Historical total shareholder return performance

Growth in value of a hypothetical £100 holding in Mears Group PLC shares over five years plotted against the AIM Index.



# GROUP ACCOUNTS

# REPORT OF THE INDEPENDENT AUDITORS – GROUP

**To the members of Mears Group PLC**

We have audited the Group financial statements of Mears Group PLC for the year ended 31 December 2006 which comprise the principal accounting policies, the consolidated income statement, the consolidated balance sheet, the consolidated statement of recognised income and expense, the consolidated cash flow statement and notes 1 to 28. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Parent Company financial statements of Mears Group PLC for the year ended 31 December 2006.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of Directors and auditors**

The Directors' responsibilities for preparing the annual report and the Group financial statements in accordance with United Kingdom law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the Chairman's Statement, the Business Review, the corporate social responsibility and corporate governance information contained in the annual report and accounts and consider whether it is consistent with the audited Group financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

**Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

**Opinion**

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs at 31 December 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

As explained in the Principal Accounting Policies the Group, in addition to complying with its legal obligation to comply with IFRS as adopted by the European Union, has also complied with the IFRS as issued by the International Accounting Standards Board.

In our opinion the Group financial statements give a true and fair view, in accordance with IFRS, of the state of the Group's affairs as at 31 December 2006 and of its profit for the year then ended.

**Grant Thornton UK LLP**
Registered Auditors
Chartered Accountants
Cheltenham
7 March 2007

# PRINCIPAL ACCOUNTING POLICIES – GROUP

**Basis of preparation**
The consolidated financial statements of the Group have been prepared in accordance with IFRS as adopted by the European Union and also in accordance with IFRS as issued by the International Accounting Standards Board. The financial statements are prepared under the historical cost convention. The accounting policies remain unchanged from the previous year.

**Basis of consolidation**
The consolidated balance sheet includes the assets and liabilities of the Company and its subsidiaries and is made up to 31 December 2006. Entities over which the Group has the ability to exercise control are accounted for as subsidiaries. Control is obtained and exercised through voting rights so as to obtain benefits from its activities. Interests acquired in entities are consolidated from the effective date of acquisition and interests sold are consolidated up to the date of disposal.

Business combinations are accounted for using the purchase method.

Balances between Group companies are eliminated; no profit is taken on sales between Group companies.

**Use of assumptions and estimates**
The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reported period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

In the preparation of these consolidated financial statements, estimates and assumptions have been made by management concerning the selection of useful lives of fixed assets, provisions necessary for certain liabilities, when to recognise revenue on long term contracts, actuarial assumptions, discount rates used within impairment reviews, the underlying share price volatility for valuing equity-based payments and other similar evaluations. Actual amounts could differ from those estimates.

**Intangible assets**
Intangible assets acquired as part of a business combination are capitalised at fair value at the date of the acquisition, amortised over the useful economic life of those assets. Where the useful economic life is considered to be indefinite, an annual impairment test is performed.

Development expenditure relating to computer software is capitalised where; an asset can be identified, it is probable that this asset will generate future economic benefits and that the cost of an asset can be measured reliably. Development expenditure is written off over the period expected to benefit. All development expenditure that does not meet these criteria is expensed as incurred.

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

| | | |
|---|---|---|
| Order book | – | over the period of the order book, typically three years |
| Client relationships | – | over the period expected to benefit, typically five years |
| Development expenditure | – | 25% per annum, straight-line |

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

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

**Impairment**
Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

An impairment loss is recognised to the extent that an asset's carrying value exceeds its recoverable amount, which represents the higher of the asset's fair value less costs to sell and its value in use. The recoverable amount of goodwill is determined by reference to the discounted future cash flows expected to be derived from the cash-generating unit to which it is allocated. Impairment losses are recognised in the income statement.

**Property, plant and equipment**
Items of property, plant and equipment are included at cost, net of depreciation. Depreciation is calculated to write down the cost less estimated residual value of all property, plant and equipment, other than freehold land, over their estimated useful economic lives. The rates generally applicable are:

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

The carrying value of property, plant and equipment is reviewed for impairment in the period if events or changes in circumstances indicate the carrying value may not be recoverable.

# PRINCIPAL ACCOUNTING POLICIES – GROUP

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

**Work in progress**
Work in progress is stated at the lower of cost and net realisable value. Cost is materials, direct labour and any subcontracted work.

**Cash and cash equivalents**
Cash and cash equivalents include cash at bank and in hand and bank deposits available at less than 24 hours' notice. Bank overdrafts are presented as current liabilities to the extent that there is no right of offset with cash balances. Money market instruments are financial assets carried at fair value through profit or loss.

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

Where an item of income or expense is recognised in the income statement, any related tax generated is recognised as a component of tax expense in the income statement. Where an item is recognised directly to equity and presented within the consolidated statement of recognised income and expense, any related tax generated is treated similarly.

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

Deferred taxation liabilities are generally recognised on all taxable temporary differences. Deferred taxation assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred taxation is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. The carrying value of deferred taxation assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available against which taxable temporary differences can be utilised. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

**Revenue**
Social housing and vehicle distribution services – when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction is recognised by reference to the stage of completion of the transaction at the balance sheet date. The outcome of the transaction is deemed to be able to be estimated reliably when all the following conditions are satisfied:

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

Where a contract for goods or services involves delivery of several different elements and is not fully delivered or performed by the year end, revenue is recognised based on the proportion of the fair value of the elements delivered to the fair value of the overall contract.

Construction contracts – revenue from the mechanical and electrical sector reflects the contract activity during the year and is measured at the fair value of consideration received or receivable. When the outcome can be assessed reliably, contract revenue and associated costs are recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date. The stage of completion of the contract at the balance sheet date is assessed by comparing the value of work certified to date with the total value of the contract. Where the outcome of a construction contract cannot be estimated reliably revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable and contract costs are recognised as an expense in the period in which they are incurred.

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

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

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

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

**Employee benefits**
Pensions to employees are provided through a defined benefit plan as well as several defined contribution plans.

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

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

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

Scheme assets are measured at fair values. Scheme liabilities are measured on an actuarial basis using the projected unit method and are discounted at appropriate high quality corporate bond rates that have terms to maturity approximating to the terms of the related liability. Appropriate adjustments are made for past service costs. Past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that benefits are already vested the Group recognises past service cost immediately.

Actuarial gains and losses are recognised immediately through the statement of recognised income and expense. The net surplus or deficit is presented with other net assets on the balance sheet. Any related deferred tax is shown with other deferred tax balances. A surplus is recognised only to the extent that it is recoverable by the Group.

**Share-based employee remuneration**
All share-based payment arrangements that were granted after 7 November 2002 are recognised in the consolidated financial statements.

The Group operates equity-settled share-based remuneration plans for its employees. All employee services received in exchange for the grant of any share-based remuneration are measured at their fair values. These are indirectly determined by reference to the fair value of the share options awarded. Their value is determined at the date of grant and is not subsequently remeasured unless the conditions on which the award was granted are modified. The fair value at the date of the grant is calculated using the Binomial Option pricing model and the cost is recognised on a straight-line basis over the vesting period. Adjustments are made to reflect expected and actual forfeitures during the vesting period to satisfy service conditions.

All share-based remuneration is ultimately recognised as an expense in the income statement with a corresponding credit to additional paid-in capital, net of deferred tax where applicable.

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

**Leases**
In accordance with IAS 17 (rev 2003), the economic ownership of a leased asset is transferred to the lessee if they bear substantially all the risks and rewards related to the ownership of the leased asset. The related asset is recognised at the time of inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any, to be borne by the lessee. A corresponding amount is recognised as a finance leasing liability, irrespective of whether some of these lease payments are payable up-front at the date of inception of the lease.

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

All other leases are treated as operating leases. Payment on operating lease agreements is recognised as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred. The Group does not act as a lessor.

**Financial liabilities/assets**
The Group's financial liabilities are overdrafts, trade and other payables and finance leasing liabilities. They are included in the balance sheet line items 'Short term borrowings and overdrafts', 'Long term financial liabilities' and 'Trade and other payables'.

Financial liabilities are recognised when the Group becomes party to the contractual agreements of the instrument. All interest related charges are recognised as an expense in 'finance cost' in the income statement.

Finance lease liabilities are measured at initial value less the capital element of lease repayments.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivables. Loans and receivables are subsequently measured at amortised cost using the effective interest method, less provision for impairment. Any change in their value through impairment or reversal of impairment is recognised in the income statement.

Provision against trade receivables is made when objective evidence is received that the Group will not be able to collect all amounts due to it in accordance with the original terms of those receivables. The amount of the write down is determined as the difference between the asset's carrying amount and the present value of estimated future cash flows.

**Equity instruments**
Share capital is determined using the nominal value of shares that have been issued. Equity-settled shared-based employee remuneration is credited to the share-based payment reserve until the related share options are exercised.

# CONSOLIDATED INCOME STATEMENT

**For the year ended 31 December 2006**

| | Note | 2006 £'000 | 2006 £'000 | 2005 £'000 | 2005 £'000 |
|---|---|---|---|---|---|
| **Sales revenue** | 1 | | **241,414** | | 203,543 |
| Cost of sales | | | **(174,399)** | | (144,954) |
| **Gross profit** | | | **67,015** | | 58,589 |
| Other administrative expenses | | **(53,970)** | | (48,302) | |
| Operating result before share-based payments and intangible amortisation | | **13,045** | | 10,287 | |
| Intangible amortisation | 10 | **(255)** | | — | |
| Share-based payments | 5 | **(535)** | | (515) | |
| **Total administrative costs** | | | **(54,760)** | | (48,817) |
| **Operating result** | 1 | | **12,255** | | 9,772 |
| Finance income | 3 | | **130** | | 70 |
| Finance costs | 3 | | **(118)** | | (92) |
| **Result for the year before tax** | 2 | | **12,267** | | 9,750 |
| Tax expense | 6 | | **(2,068)** | | (2,540) |
| **Net result for the year** | | | **10,199** | | 7,210 |
| **Earnings per share** | | | | | |
| Basic | 8 | | **17.05p** | | 12.40p |
| Diluted | 8 | | **15.99p** | | 11.45p |

All activities are continuing.

The accompanying accounting policies and notes form an integral part of these financial statements.

# CONSOLIDATED BALANCE SHEET

**At 31 December 2006**

| | Note | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current** | | | |
| Goodwill | 9 | **13,811** | 10,647 |
| Intangible assets | 10 | **1,029** | — |
| Property, plant and equipment | 11 | **5,716** | 5,827 |
| Deferred tax asset | 18 | **3,000** | 3,500 |
| | | **23,556** | 19,974 |
| **Current** | | | |
| Inventories | 13 | **9,104** | 5,363 |
| Trade and other receivables | 15 | **40,334** | 31,852 |
| Cash at bank and in hand | | **12,127** | 9,774 |
| | | **61,565** | 46,989 |
| **Total assets** | | **85,121** | 66,963 |
| **Equity** | | | |
| **Equity attributable to the shareholders of Mears Group PLC** | | | |
| Called up share capital | 19 | **615** | 588 |
| Share premium account | 20 | **5,547** | 3,960 |
| Share-based payment reserve | 20 | **1,485** | 1,040 |
| Retained earnings | 20 | **30,363** | 22,466 |
| **Total equity** | | **38,010** | 28,054 |
| **Liabilities** | | | |
| **Non-current** | | | |
| Other liabilities | 17 | **2,876** | 855 |
| | | **2,876** | 855 |
| **Current** | | | |
| Short term borrowings and overdrafts | | **228** | 2,832 |
| Trade and other payables | 16 | **42,186** | 33,215 |
| Current tax liabilities | | **1,438** | 1,764 |
| Pension and other employee benefits | 25 | **383** | 243 |
| **Current liabilities** | | **44,235** | 38,054 |
| **Total liabilities** | | **47,111** | 38,909 |
| **Total equity and liabilities** | | **85,121** | 66,963 |

The financial statements were approved by the Board of Directors on 7 March 2007.

**R Holt**
Director

**D J Robertson**
Director

The accompanying accounting policies and notes form an integral part of these financial statements.

# CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE

**For the year ended 31 December 2006**

| | Note | **2006 £'000** | 2005 £'000 |
|---|---|---|---|
| Actuarial losses on defined benefit pension scheme | 25 | **(77)** | (101) |
| (Decrease)/increase in deferred tax asset | 18 | **(550)** | 1,270 |
| Net income recognised directly to equity | | **(627)** | 1,169 |
| Profit for the financial period | | **10,199** | 7,210 |
| Total recognised income and expense for the period | | **9,572** | 8,379 |

The accompanying accounting policies and notes form an integral part of these financial statements.

# CONSOLIDATED CASH FLOW STATEMENT

**For the year ended 31 December 2006**

| | Note | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Result for the year before tax | | **12,267** | 9,750 |
| Adjustments | 21 | **2,312** | 1,974 |
| Change in inventories | | **(3,468)** | (735) |
| Change in operating receivables | | **(7,697)** | (1,442) |
| Change in operating payables | | **9,023** | 1,120 |
| Cash inflow from operating activities before taxes paid | | **12,437** | 10,667 |
| Taxes paid | | **(2,394)** | (2,271) |
| | | **10,043** | 8,396 |
| **Investing activities** | | | |
| Additions to property, plant and equipment | | **(1,593)** | (3,125) |
| Proceeds from disposals of property, plant and equipment | | **146** | 330 |
| Acquisition of subsidiary undertaking, net of cash | | **(3,543)** | (755) |
| Interest received | | **136** | 67 |
| | | **(4,854)** | (3,483) |
| **Financing activities** | | | |
| Proceeds from share issue | | **1,614** | 607 |
| Discharge of finance lease liability | | **(46)** | (75) |
| Interest paid | | **(124)** | (96) |
| Dividends paid | | **(1,676)** | (1,225) |
| | | **(232)** | (789) |
| Cash and cash equivalents, beginning of year | | **6,942** | 2,818 |
| Net increase in cash and cash equivalents | | **4,957** | 4,124 |
| **Cash and cash equivalents, end of year** | | **11,899** | 6,942 |

| | | | |
|---|---|---|---|
| Cash and cash equivalents is comprised as follows: | | | |
| Cash at bank and in hand | | **12,127** | 9,774 |
| Short term borrowings and overdrafts | | **(228)** | (2,832) |
| **Cash and cash equivalents** | | **11,899** | 6,942 |

The accompanying accounting policies and notes form an integral part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS – GROUP

### 1. Segment reporting

The Group operates three business segments: social housing, mechanical and electrical (M&E) and vehicle distribution. All of the Group's activities are carried out within the United Kingdom.

| Business segments | 2006 Social housing £'000 | 2006 M&E £'000 | 2006 Vehicle distribution £'000 | 2006 Total £'000 | 2005 Social housing £'000 | 2005 M&E £'000 | 2005 Vehicle distribution £'000 | 2005 Total £'000 |
|---|---|---|---|---|---|---|---|---|
| **Revenue** | **184,017** | **49,069** | **8,328** | **241,414** | 144,086 | 50,820 | 8,637 | 203,543 |
| **Operating result pre share-based payments and amortisation** | **10,697** | **1,937** | **411** | **13,045** | 7,964 | 1,908 | 415 | 10,287 |
| Amortisation | **(255)** | **—** | **—** | **(255)** | — | — | — | — |
| Share-based payments | **(374)** | **(144)** | **(17)** | **(535)** | (400) | (75) | (40) | (515) |
| **Operating result** | **10,068** | **1,793** | **394** | **12,255** | 7,564 | 1,833 | 375 | 9,772 |
| Finance costs, net | **(147)** | **44** | **115** | **12** | (237) | 94 | 121 | (22) |
| Tax expense | **(1,680)** | **(288)** | **(100)** | **(2,068)** | (1,970) | (470) | (100) | (2,540) |
| **Net result for the year** | **8,241** | **1,549** | **409** | **10,199** | 5,357 | 1,457 | 396 | 721 |
| **Segment assets** | **58,627** | **22,373** | **4,121** | **85,121** | 44,908 | 18,351 | 3,704 | 66,963 |
| **Segment liabilities** | **(31,327)** | **(14,372)** | **(1,412)** | **(47,111)** | (26,091) | (11,361) | (1,457) | (38,909) |
| **Depreciation** | **1,046** | **346** | **121** | **1,513** | 860 | 475 | 123 | 1,458 |

### 2. Result for the year before tax

Result for the year before tax is stated after:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Auditors' remuneration | | |
| – audit services | **38** | 35 |
| – audit of subsidiary undertakings | **87** | 80 |
| – non-audit services | **40** | 50 |
| Share-based payments | **535** | 515 |
| Depreciation | **1,513** | 1,458 |
| Amortisation | **255** | — |
| Hire of plant and machinery | **1,030** | 780 |
| Other operating lease rentals | **5,747** | 5,224 |

Included within non-audit services are tax compliance fees of £25,000, tax advice fees of £10,000 and other advice fees of £5,000.

### 3. Finance income and finance costs

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Interest charge on overdrafts | **(108)** | (82) |
| Finance charges in respect of finance leases | **(10)** | (10) |
| **Finance costs** | **(118)** | (92) |
| Interest income resulting from short term bank deposits | **130** | 70 |
| **Net finance income/(charge)** | **12** | (22) |

## 4. Directors and employees

Staff costs during the year were as follows:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Wages and salaries | **62,633** | 56,411 |
| Social security costs | **5,879** | 5,398 |
| Other pension costs | **872** | 596 |
| | **69,384** | 62,405 |

The average number of employees of the Group during the year was:

| | 2006 Number | 2005 Number |
|---|---|---|
| Site workers | **1,529** | 1,423 |
| Office and management | **867** | 826 |
| | **2,396** | 2,249 |

Remuneration in respect of Directors was as follows:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Emoluments | **754** | 932 |
| Gains made on the exercise of share options | **911** | — |
| Pension contributions to personal pension schemes | **125** | 135 |
| Compensation for loss of office | — | 197 |
| | **1,790** | 1,264 |

The amounts set out above include remuneration in respect of the highest paid Director as follows:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Emoluments | **192** | 369 |
| Gains made on the exercise of share options | **911** | — |
| Pension contributions to personal pension schemes | **26** | 75 |

During the year contributions were paid to personal pension schemes for three Directors (2005: three).

During the year one Director (2005: none) exercised their share options.

## 5. Share-based employee remuneration

As at 31 December 2006 the Group maintained four share-based payment schemes for employee remuneration.

### Approved share option plan

Options are exercisable at a price equal to the average quoted market price of the Company's shares on the three dealing days prior to the date of grant. The vesting period is three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves the Mears Group before the options vest.

Details of the share options outstanding during the year are:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Number '000 | Weighted average exercise price p | Number '000 | Weighted average exercise price p |
| Outstanding at 1 January | **802** | **169** | 829 | 120 |
| Granted | **523** | **300** | 251 | 231 |
| Forfeited | **(55)** | **231** | (173) | 82 |
| Exercised | **(60)** | **50** | (105) | 74 |
| Outstanding at 31 December | **1,210** | **229** | 802 | 169 |

The weighted average share price at the date of exercise for share options exercised during the period was 304.5p. The options outstanding at 31 December 2006 were exercisable at prices between 50p and 300p and had a weighted average remaining contractual life of 8.2 years.

# NOTES TO THE FINANCIAL STATEMENTS – GROUP

### 5. Share-based employee remuneration continued

**Enterprise Management Incentive (EMI) plan**

Options are exercisable at a price equal to the average quoted market price of the Company's shares on the three dealing days prior to the date of grant. The vesting period is three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves the Mears Group before the options vest.

Details of the share options outstanding during the year are:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Number '000 | Weighted average exercise price p | Number '000 | Weighted average exercise price p |
| Outstanding at 1 January | 2,051 | 61 | 2,793 | 60 |
| Granted | — | — | — | — |
| Forfeited | (20) | 77 | (50) | 68 |
| Exercised | (1,453) | 57 | (692) | 59 |
| Outstanding at 31 December | 578 | 71 | 2,051 | 61 |

The weighted average share price at the date of exercise for share options exercised during the period was 298.6p. The options outstanding at 31 December 2006 were exercisable at prices between 50p and 77p and had a weighted average remaining contractual life of 5.9 years.

**Unapproved share option plan**

Options are exercisable at a price equal to the average quoted market price of the Company's shares on the three dealing days prior to the date of grant. The vesting period is three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves the Mears Group before the options vest.

Details of the share options outstanding during the year are:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Number '000 | Weighted average exercise price p | Number '000 | Weighted average exercise price p |
| Outstanding at 1 January | 3,761 | 113 | 3,560 | 93 |
| Granted | 385 | 300 | 526 | 242 |
| Forfeited | (69) | 179 | (325) | 102 |
| Exercised | (940) | 71 | — | — |
| Outstanding at 31 December | 3,137 | 148 | 3,761 | 113 |

The weighted average share price at the date of exercise for share options exercised during the period was 282p. The options outstanding at 31 December 2006 were exercisable at prices between 68p and 300p and had a weighted average remaining contractual life of 7.1 years.

**Save As You Earn (SAYE) scheme**

Options are available to all employees. Options are granted for a period of either three or five years. Options are exercisable at a price based on the quoted market price of the Company's shares at the time of invitation, discounted by 20%. Options are forfeited if the employee leaves the Mears Group before the options vest.

Details of the share options outstanding during the year are:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Number '000 | Weighted average exercise price p | Number '000 | Weighted average exercise price p |
| Outstanding at 1 January | 1,050 | 147 | 1,035 | 114 |
| Granted | 341 | 230 | 293 | 216 |
| Forfeited | (123) | 168 | (120) | 109 |
| Exercised | (196) | 89 | (158) | 85 |
| Outstanding at 31 December | 1,072 | 182 | 1,050 | 147 |

The weighted average share price at the date of exercise for share options exercised during the period was 301p. The options outstanding at 31 December 2006 were exercisable at prices between 83p and 230p and had a weighted average remaining contractual life of 2.4 years.

### 5. Share-based employee remuneration continued

#### Save As You Earn (SAYE) scheme continued

All share-based employee remuneration will be settled in equity. The Group has no legal obligation to repurchase or settle the options.

The fair values of options granted were determined using the Binomial Option pricing model. Significant inputs into the calculation include the market price at the date of grant and exercise prices. Furthermore, the calculation takes into account the future dividend yield, the share price volatility rate and the risk-free interest rate.

The underlying expected share price volatility was determined by reference to historical data. The Company expects the volatility of its share price to reduce as it matures. The risk-free interest rate was determined by the implied yield available on a zero-coupon government bond at the date of grant. Adjustments are made to reflect expected and actual forfeitures during the vesting period due to failure to satisfy service conditions.

In total, £0.5m of employee remuneration expense has been included in the consolidated income statement for 2006 (2005: £0.5m), which gave rise to additional paid-in capital. No liabilities were recognised due to share-based payment transactions.

The fair values of options granted during 2005 and 2006, together with the significant inputs into the calculations, are detailed below:

| Option scheme | Date of grant | Number granted | Share price at date of grant | Exercise price | Volatility | Risk-free rate | Exit rate | Vesting conditions | Estimate of option fair value |
|---|---|---|---|---|---|---|---|---|---|
| ESOP and unapproved | Apr 2005 | 622,500 | 231p | 231p | 22% | 4.75% | 20% | 3 years' service | 45p |
| ESOP and unapproved | Oct 2005 | 150,000 | 268p | 268p | 20% | 4.50% | — | 3 years' service | 66p |
| SAYE | Oct 2005 | 184,711 | 269p | 216p | 20% | 4.50% | 30% | 3 years' service | 59p |
| SAYE | Oct 2005 | 107,910 | 269p | 216p | 20% | 4.50% | 30% | 5 years' service | 56p |
| ESOP and unapproved | Apr 2006 | 908,500 | 300p | 300p | 20% | 4.50% | 20% | 3 years' service | 37p |
| SAYE | Oct 2006 | 215,163 | 299p | 230p | 16% | 4.75% | 30% | 3 years' service | 47p |
| SAYE | Oct 2006 | 119,840 | 299p | 230p | 16% | 4.75% | 30% | 5 years' service | 34p |

267,405 options lapsed during the year. The market price at 31 December 2006 was 363p and the range during 2006 was 255p to 363p.

The following options have been granted to current Directors:

| Director | 1 January 2006 | Number of options during the year: Granted | Number of options during the year: Exercised | **31 December 2006** | Exercise price | Exercise dates |
|---|---|---|---|---|---|---|
| R Holt | 435,000 | — | — | **435,000** | 77p | 2006–2013 |
| | 50,000 | — | — | **50,000** | 154p | 2007–2014 |
| D J Robertson | 208,000 | — | (200,000) | **8,000** | 50p | 2004–2011 |
| | 200,000 | — | (200,000) | **—** | 67.5p | 2005–2012 |
| | 200,000 | — | — | **200,000** | 77p | 2006–2013 |
| | 4,612 | — | (4,612) | **—** | 100p | 2006 |
| | 50,000 | — | — | **50,000** | 154p | 2007–2014 |
| | 40,000 | — | — | **40,000** | 231p | 2008–2015 |
| | — | 35,000 | — | **35,000** | 300p | 2009–2016 |
| D J Miles | 265,463 | — | (265,463) | **—** | 67.5p | 2005–2012 |
| | 150,000 | — | (150,000) | **—** | 77p | 2006–2013 |
| | 50,000 | — | — | **50,000** | 154p | 2007–2014 |
| | 15,000 | — | — | **15,000** | 231p | 2008–2015 |
| | — | 25,000 | — | **25,000** | 300p | 2009–2016 |

# NOTES TO THE FINANCIAL STATEMENTS – GROUP

## 6. Tax expense

The tax charge represents:

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| United Kingdom corporation tax effective rate 17.0% (27.4%) | **2,118** | 2,670 |
| Total current tax | **2,118** | 2,670 |
| Reversal of deferred tax timing differences | **(50)** | (130) |
| Tax expense | **2,068** | 2,540 |

The charge for the year can be reconciled to the income statement as follows:

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Result for the year before tax | **12,267** | 9,750 |
| Result for the year multiplied by standard rate of corporation tax in the United Kingdom of 30% (2005: 30%) | **3,680** | 2,925 |
| Effect of: | | |
| Expenses not deductible for tax purposes | **251** | 161 |
| Capital allowances in excess of depreciation | **(6)** | (49) |
| Tax relief on exercise of share options | **(1,765)** | (407) |
| Utilisation of tax losses | **(92)** | (90) |
| Actual tax expense, net | **2,068** | 2,540 |

## 7. Dividends

The following dividends were declared on ordinary shares in the year:

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Final 2005 dividend of 1.90p (2005: final 2004 dividend of 1.40p) per share | **1,125** | 815 |
| Interim 2006 dividend of 0.90p (2005: interim 2005 dividend of 0.70p) per share | **550** | 410 |
| | **1,675** | 1,225 |

The proposed final dividend of 2.40p per share has not been included within the Group financial statements as no obligation existed at 31 December 2006.

## 8. Earnings per share

Basic earnings per share is based on equity earnings of £10.20m (2005: £7.21m) and 59.82m (2005: 58.16m) ordinary shares at 1p each, being the average number of shares in issue during the year.

For diluted earnings per share the average number of shares in issue is increased to 63.79m (2005: 62.97m) to reflect the potential dilution effect of employee share schemes.

A normalised earnings per share is disclosed in order to show performance undistorted by amortisation of intangibles and the tax effect of share options. The normalised earnings per share is based on equity earnings of £8.69m (2005: £6.80m).

| | Basic | | Diluted | |
|---|---|---|---|---|
| | **2006 p** | 2005 p | **2006 p** | 2005 p |
| Earnings per share | **17.05** | 12.40 | **15.99** | 11.45 |
| Effect of amortisation of intangibles of £0.26m (2005: £nil) | **0.35** | — | **0.33** | — |
| Effect of share option tax adjustment of £1.77m (2005: £0.41m) | **(2.87)** | (0.70) | **(2.69)** | (0.65) |
| Normalised pre amortisation earnings per share | **14.53** | 11.70 | **13.63** | 10.80 |

### 9. Goodwill

| | Goodwill arising on consolidation £'000 | Purchased goodwill £'000 | Total £'000 |
|---|---|---|---|
| **Gross carrying amount** | | | |
| At 1 January 2005 | 10,580 | 489 | 11,069 |
| Additions | 30 | — | 30 |
| Revision | (452) | — | (452) |
| At 1 January 2006 | 10,158 | 489 | 10,647 |
| Additions | 3,827 | — | 3,827 |
| Revision | (580) | (83) | (663) |
| **At 31 December 2006** | **13,405** | **406** | **13,811** |
| **Accumulated impairment losses** | | | |
| **At 1 January 2005, at 1 January 2006 and at 31 December 2006** | **—** | **—** | **—** |
| **Carrying amount** | | | |
| **At 31 December 2006** | **13,405** | **406** | **13,811** |
| At 31 December 2005 | 10,158 | 489 | 10,647 |
| At 31 December 2004 | 10,580 | 489 | 11,069 |

Additions to goodwill arising on consolidation is detailed within note 22.

The revision to goodwill relates to the release of the deferred consideration on the previous acquisition of Powersave Limited and Sheffield Décor Services. This contingent consideration was based on a multiple of future earnings. The Directors do not consider that any further monies will be payable on either of these acquisitions.

The carrying value of goodwill is primarily comprised of the following cash-generating units:

| | Goodwill arising on consolidation £'000 | Purchased goodwill £'000 | Total £'000 |
|---|---|---|---|
| Social housing | 7,444 | 406 | 7,850 |
| M&E | 4,331 | — | 4,331 |
| Vehicle distribution | 1,630 | — | 1,630 |
| | 13,405 | 406 | 13,811 |

Goodwill is not amortised but is reviewed for impairment on an annual basis or more frequently if there are any indications that goodwill may be impaired. Goodwill acquired in a business combination is allocated to groups of cash-generating units according to the level at which management monitor that goodwill. Goodwill is carried at cost less accumulated impairment losses.

An asset is impaired if its carrying value exceeds the unit's recoverable amount which is based upon value in use. At 31 December 2006, 2005 and 2004 impairment reviews were performed by comparing the carrying value of goodwill with the value in use of the cash-generating units to which goodwill has been allocated. The value in use is calculated based upon the cash flow projections over ten years discounted at the Mears weighted average cost of capital of 9%. The cash flow projections assumed an annual growth rate of 2.5% for years one to five with no further growth beyond this. The projections assume a corporation tax rate of 30%.

# NOTES TO THE FINANCIAL STATEMENTS – GROUP

### 10. Other intangible assets

| | | Arising on consolidation | | |
|---|---|---|---|---|
| | Development expenditure £'000 | Order book £'000 | Client relationships £'000 | Total £'000 |
| Gross carrying amount | | | | |
| At 1 January 2005 and at 1 January 2006 | — | — | — | — |
| Acquired on acquisition of subsidiary | — | 134 | 928 | 1,062 |
| Additions | 222 | — | — | 222 |
| **At 31 December 2006** | **222** | **134** | **928** | **1,284** |
| **Accumulated amortisation** | | | | |
| At 1 January 2005 and at 1 January 2006 | — | — | — | — |
| Amortisation charge for period | — | 32 | 223 | 255 |
| **At 31 December 2006** | **—** | **32** | **223** | **255** |
| **Carrying amount** | | | | |
| **At 31 December 2006** | **222** | **102** | **705** | **1,029** |
| At 31 December 2005 | — | — | — | — |
| At 31 December 2004 | — | — | — | — |

Development expenditure relates to internal computer software development. Additions to Intangible fixed assets arising on consolidation are detailed within note 22.

### 11. Property, plant and equipment

| | Freehold land and buildings £'000 | Leasehold improvements £'000 | Plant and machinery £'000 | Fixtures, fittings and equipment £'000 | Motor vehicles £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| **Gross carrying amount** | | | | | | |
| At 1 January 2005 | 69 | 631 | 2,543 | 5,130 | 959 | 9,332 |
| Additions | — | 1,535 | 369 | 1,137 | 84 | 3,125 |
| Disposals | (60) | — | (299) | (23) | (279) | (661) |
| At 1 January 2006 | 9 | 2,166 | 2,613 | 6,244 | 764 | 11,796 |
| Additions | — | 177 | 27 | 1,100 | 65 | 1,369 |
| Acquisition of subsidiary | — | 44 | 25 | 42 | 376 | 487 |
| Disposals | — | (43) | (178) | (549) | (106) | (876) |
| **At 31 December 2006** | **9** | **2,344** | **2,487** | **6,837** | **1,099** | **12,776** |
| **Depreciation** | | | | | | |
| At 1 January 2005 | 9 | 391 | 1,590 | 2,304 | 588 | 4,882 |
| Provided in the year | 2 | 205 | 215 | 927 | 109 | 1,458 |
| Eliminated on disposals | (4) | — | (180) | (19) | (168) | (371) |
| At 1 January 2006 | 7 | 596 | 1,625 | 3,212 | 529 | 5,969 |
| Provided in the year | — | 258 | 158 | 995 | 102 | 1,513 |
| Acquisition of subsidiary | — | 8 | 16 | 28 | 236 | 288 |
| Eliminated on disposals | — | (30) | (62) | (549) | (69) | (710) |
| **At 31 December 2006** | **7** | **832** | **1,737** | **3,686** | **798** | **7,060** |
| **Carrying amount** | | | | | | |
| **At 31 December 2006** | **2** | **1,512** | **750** | **3,151** | **301** | **5,716** |
| At 31 December 2005 | 2 | 1,570 | 988 | 3,032 | 235 | 5,827 |
| At 31 December 2004 | 60 | 240 | 953 | 2,826 | 371 | 4,450 |

### 11. Property, plant and equipment continued

The figures stated above include assets held under finance leases as follows:

| | Plant and machinery £'000 |
|---|---|
| **Net book amount** | |
| **At 31 December 2006** | **98** |
| At 31 December 2005 | 69 |
| **Depreciation provided in the year** | **20** |

### 12. Investments

The principal undertakings within the Group are shown below:

| | Proportion held | Nature of business |
|---|---|---|
| Mears Limited | 100% | Provision of maintenance services |
| United Fleet Distribution Limited | 100% | Vehicle collection and delivery |
| Haydon Mechanical & Electrical Limited | 100% | Provision of mechanical and electrical services |
| Powersave Limited | 100% | Provision of heating and air conditioning services |
| Scion Group Limited | 100% | Provision of mechanical and electrical services and grounds maintenance |
| Laidlaw Scott Limited | 100% | Provision of maintenance services |
| Mears Insurance Captive Limited | 99.99% | Provision of insurance services |

All subsidiary undertakings prepare accounts to 31 December. All subsidiary undertakings are registered in England and Wales with the exception of Mears Insurance Captive Limited which is registered in Guernsey.

A full list of subsidiary undertakings is available from the Company Secretary upon request.

### 13. Inventories

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Materials and consumables | **842** | 717 |
| Work in progress | **8,262** | 4,646 |
| | **9,104** | 5,363 |

### 14. Construction contracts

Revenue of £38.6m (2005: £35.0m) relating to construction contracts has been included in revenue.

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Contract costs incurred | **31,810** | 27,274 |
| Recognised gross profits | **6,775** | 7,693 |
| Recognised gross losses | **—** | — |
| | **38,585** | 34,967 |
| Balances outstanding comprise: | | |
| Retentions | **1,459** | 1,649 |
| Due from customers for construction contract work | **2,629** | 2,341 |
| Due to customers for construction contract work | **(1,530)** | (2,408) |

Retentions will be payable upon acceptance of the work performed by the customer. The amounts due to customers for construction work are included in 'Trade and other payables'.

# NOTES TO THE FINANCIAL STATEMENTS – GROUP

### 15. Trade and other receivables

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Trade receivables | **25,970** | 22,900 |
| Amounts recoverable on construction contracts | **2,629** | 2,341 |
| Amounts recoverable on non-construction contracts | **9,774** | 4,866 |
| Prepayments and accrued income | **1,961** | 1,745 |
| | **40,334** | 31,852 |

Trade receivables are normally due within 30 to 60 days and do not bear any effective interest rate. All trade receivables are subject to credit risk exposure. However, there is no specific concentration of credit risk as the amounts recognised represent a large number of receivables from various customers. Included in trade receivables is an amount of £0.7m (2005: £0.8m) which is due after more than one year and represents retention balances.

### 16. Trade and other payables

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Trade payables | **22,803** | 15,930 |
| Accruals and deferred income | **11,046** | 7,682 |
| Social security and other taxes | **6,239** | 5,556 |
| Due to customers for construction contract work | **1,530** | 2,408 |
| Other creditors | **511** | 1,593 |
| Amounts due under finance lease contracts | **57** | 46 |
| | **42,186** | 33,215 |

The fair value of trade payables has not been disclosed as due to their short duration, management considers the carrying amounts recognised in the balance sheet to be a reasonable approximation of their fair value.

The amounts due under construction contract work will generally be utilised within the next reporting period.

The amounts due under finance lease contracts are secured on the assets to which they relate.

### 17. Long term financial liabilities

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Other creditors | **2,820** | 855 |
| Amounts due under finance lease contracts | **56** | — |
| | **2,876** | 855 |

Included in other creditors is £3.0m (2005: £2.2m), of which £0.2m (2005: £1.3m) is included within trade and other payables and falls due within one year, relating to deferred consideration on the acquisitions of R Carter & Sons Limited and Laidlaw Scott Limited.

#### Financial instruments

The Company uses financial instruments, comprising borrowings, cash and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial instruments is to finance the Company's operations.

The main financial risks of the Group relate to the availability of funds to meet business needs and the risk of default by counter-parties to financial transactions.

The Group seeks to manage liquidity risk by ensuring sufficient liquidity is available to meet foreseeable needs and to invest cash assets safely and profitably.

Trade debtors are normally due within 30 to 60 days. All trade debtors are subject to credit risk exposure. However there is no specific concentration of credit risk as the amounts recognised represent a large number of receivables from various customers.

The Company has no interests in the trade of financial instruments, interest rate swaps or forward interest rate agreements.

## 17. Long term financial liabilities continued

### Interest rate risk

The Group finances its operations through a mixture of retained profits and bank borrowings.

The book and fair value of interest rate exposure on financial liabilities of the Group as at 31 December 2006 was:

| | Interest rate | | | |
|---|---|---|---|---|
| | Fixed £'000 | Floating £'000 | Zero £'000 | Total £'000 |
| **Financial liabilities – 2006** | **113** | **228** | **3,000** | **3,341** |
| Financial liabilities – 2005 | 46 | 2,832 | 2,175 | 5,053 |

Included above in floating interest rate exposure is a £0.23m bank overdraft. The interest rate risk on this liability is directly offset by cash at bank of £12.13m.

The floating rate borrowings bear interest at rates based on LIBOR. The fixed rate borrowings relate to finance leases.

The bank overdraft facility is secured by a fixed and floating charge over the Group's assets.

## 18. Deferred taxation

The Group asset for deferred tax as at 31 December 2006, which relates entirely to share-based payments, is £3.0m (2005: £3.5m).

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| At 1 January 2006 | **3,500** | 2,100 |
| Credit to income statement | **50** | 130 |
| (Debit)/credit to consolidated statement of recognised income and expense | **(550)** | 1,270 |
| | **3,000** | 3,500 |

In accordance with IFRS 2 "Share-based Payments", the Group has recognised an expense for the consumption of employee services received as consideration for share options granted. A tax deduction will not arise until the options are exercised. The tax deduction in future periods is dependent upon the Company's share price at the date of exercise. The estimated future tax deduction is based on the options' intrinsic value at the balance sheet date.

The cumulative amount credited to the income statement is limited to the tax effect of the associated cumulative share-based payment expense. The excess has been credited directly to equity. This is presented in the consolidated statement of recognised income and expense.

The deferred tax asset that arises on pre 7 November 2002 grants, even though the grants themselves are not accounted for within the income statement, is credited directly to equity.

## 19. Share capital

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| **Authorised** | | |
| 100,000,000 ordinary shares of 1p each | **1,000** | 1,000 |
| **Allotted, called up and fully paid** | | |
| 61,476,713 (2005: 58,828,199) ordinary shares of 1p each | **615** | 588 |

During the year 2,648,514 ordinary shares of 1p each were issued for consideration of £1.61m as a result of share options being exercised. The difference between the nominal value of £0.03m and the total consideration of £1.61m has been credited to the share premium account.

# NOTES TO THE FINANCIAL STATEMENTS – GROUP

### 20. Reconciliation of movement in equity

| | Share capital £'000 | Share premium account £'000 | Share-based payment reserve £'000 | Retained earnings £'000 | Minority interest £'000 | Total equity £'000 |
|---|---|---|---|---|---|---|
| At 1 January 2005 | 579 | 3,362 | 525 | 15,312 | 95 | 19,873 |
| Net result for the year | — | — | — | 7,210 | — | 7,210 |
| Deferred tax | — | — | — | 1,270 | — | 1,270 |
| Pension obligation | — | — | — | (101) | — | (101) |
| **Total recognised income and expense for the year** | — | — | — | 8,379 | — | 8,379 |
| Acquisition of minority interests | — | — | — | — | (95) | (95) |
| Issue of shares | 9 | 598 | — | — | — | 607 |
| Share option charges | — | — | 515 | — | — | 515 |
| Dividends | — | — | — | (1,225) | — | (1,225) |
| At 31 December 2005 | 588 | 3,960 | 1,040 | 22,466 | — | 28,054 |
| Net result for the year | — | — | — | 10,199 | — | 10,199 |
| Deferred tax | — | — | — | (550) | — | (550) |
| Pension obligation | — | — | — | (77) | — | (77) |
| **Total recognised income and expense for the year** | — | — | — | 9,572 | — | 9,572 |
| Issue of shares | 27 | 1,587 | — | — | — | 1,614 |
| Share option charges | — | — | 535 | — | — | 535 |
| Revision to previous year acquisition | — | — | (90) | — | — | (90) |
| Dividends | — | — | — | (1,675) | — | (1,675) |
| **At 31 December 2006** | **615** | **5,547** | **1,485** | **30,363** | **—** | **38,010** |

The revision to the valuation of options issued in respect of a prior year acquisition relates to an adjustment to the value of the Directors' best estimate of contingent consideration payable in respect of the acquisition of Powersave Limited.

### 21. Notes to consolidated cash flow statement

The following non operating cash flow adjustments have been made to the pre-tax result for the year:

| | **2006 £'000** | 2005 £'000 |
|---|---|---|
| Depreciation | **1,513** | 1,458 |
| Loss/(profit) on disposal of fixed assets | **21** | (21) |
| Amortisation | **255** | — |
| Share-based payments | **535** | 515 |
| Finance income | **(130)** | (70) |
| Finance cost | **118** | 92 |
| Total | **2,312** | 1,974 |

**22. Acquisitions**
On 6 June 2006 the Group acquired the entire issued share capital of Laidlaw Scott Limited for £5.10m (including acquisition costs), satisfied by £2.24m cash and contingent consideration of £2.82m. The contingent consideration is payable during 2008 and is based on post tax profits for the 18 months to 31 December 2007. The contingent consideration included represents the Directors' best estimate of contingent consideration payable. The maximum total consideration that could be payable, including acquisition costs is £5.10m. The purchase has been accounted for by the acquisition method of accounting.

The assets and liabilities acquired were as follows:

| | Book value £'000 | Adjustments £'000 | Fair value £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current** | | | |
| Property, plant and equipment | 259 | (60) | 199 |
| **Current** | | | |
| Inventories | 273 | — | 273 |
| Trade receivables | 860 | (25) | 835 |
| Cash at bank and in hand | 75 | — | 75 |
| Total assets | 1,467 | (85) | 1,382 |
| **Liabilities** | | | |
| **Current** | | | |
| Trade payables | 880 | 5 | 885 |
| Other creditors | 113 | — | 113 |
| Accruals | 150 | 65 | 215 |
| Total liabilities | 1,143 | 70 | 1,213 |

| | |
|---|---|
| Fair value of net assets acquired | 169 |
| Intangibles capitalised | 1,062 |
| Goodwill capitalised | 3,827 |
| | 5,058 |
| Satisfied by: | |
| Cash | 2,238 |
| Deferred consideration | 2,820 |
| | 5,058 |

Provisional fair value adjustments represent the write off of a revaluation of tangible fixed assets totalling £0.06m and other adjustments of £0.01m.

The loss after taxation for the nine month period from the beginning of the financial year of the acquired company to the date of acquisition was £0.05m. The profit after taxation for the financial year prior to acquisition of the Company acquired was £0.34m in aggregate. The profit after taxation for the six month period since acquisition was £0.27m.

Laidlaw Scott holds contracts with a number of customers. The value placed on this order book is based upon the cash flow projections over the contract term discounted at the Laidlaw Scott weighted average cost of capital of 11%. The projections assume a corporation tax rate of 30%.

In addition Laidlaw Scott benefits from customer relationships where there is a practice of establishing contracts with its customers, although no contracts existed at the date of acquisition. The value placed on client relationships is based upon the cash flow projections over five years discounted at the Laidlaw Scott weighted average cost of capital of 11%. The cash flow projections assumed an attrition rate of customers is 20% and all acquired customers will have been replaced within five years. The projections assume a corporation tax rate of 30%.

# NOTES TO THE FINANCIAL STATEMENTS – GROUP

### 22. Acquisitions continued

The Directors consider that the value assigned to goodwill is significantly higher than that assigned to intangible assets because the value of the acquired business predominantly lies with the following components:

- its geographical location providing access to the Scottish market;
- its workforce; and
- synergies arising from cost savings and increased market share.

Analysis of net outflow in respect of the purchase of the subsidiary undertakings:

| | **2006 £'000** |
|---|---|
| Cash at bank and in hand acquired | **75** |
| Cash consideration | **(2,238)** |
| | **(2,163)** |

During the year the Group and Company paid £1.4m in respect of contingent consideration relating to acquisitions in prior periods.

### 23. Capital commitments

The Group had no capital commitments at 31 December 2006 or at 31 December 2005.

### 24. Contingent liabilities

The Group has guaranteed that it will complete the contracts it has commenced with 18 (2005: 18) local authorities. At 31 December 2006 these guarantees amounted to £1.89m (2005: £2.11m).

The Group had no other contingent liabilities at 31 December 2006 or at 31 December 2005.

### 25. Pensions

#### Defined contribution schemes

The Group operates a defined contribution Group personal pension scheme for the benefit of certain employees. The Group contributes to personal pension schemes of certain Directors and senior employees. The Group operates a stakeholder pension plan available to all employees. During the year, the Group contributed £0.79m (2005: £0.48m) to these schemes.

#### Defined benefit scheme

The Group contributes to defined benefit schemes on behalf of a number of employees. The Group operates a defined benefit pension scheme for the benefit of certain employees of a subsidiary company, Scion Group Limited and its subsidiary undertakings. The assets of the scheme are administered by trustees in a fund independent from the assets of the Group.

#### IAS 19 'Employee Benefits'

Costs and liabilities of the scheme are based on actuarial valuations. The latest full actuarial valuation was carried out at 31 March 2003 and updated to 31 December 2006 by a qualified independent actuary using the projected unit method.

The Group has adopted the amendment to IAS 19 in the current year.

The amounts recognised in the balance sheet and expected rates of return on investments are:

| | **2006** | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | **%** | **£'000** | % | £'000 | % | £'000 |
| Equities | **7.6** | **986** | 7.1 | 836 | 7.5 | 522 |
| Bonds | **4.9** | **63** | 4.7 | 32 | 4.9 | 57 |
| Cash | **5.0** | **96** | 4.5 | 71 | 4.8 | 73 |
| Group's estimated asset share | | **1,145** | | 939 | | 652 |
| Present value of funded scheme liabilities | | **(1,528)** | | (1,182) | | (794) |
| Net pension liability | | **(383)** | | (243) | | (142) |

The amounts recognised in the income statement are as follows:

| | **2006 £'000** | 2005 £'000 | 2004 £'000 |
|---|---|---|---|
| Current service cost | **151** | 120 | 121 |
| Past service cost | **—** | — | 5 |
| Total operating charge | **151** | 120 | 126 |
| Amount that would have been charged to net interest payable: | | | |
| Expected return on pension scheme assets | **68** | 51 | 38 |
| Expected return on pension scheme liabilities | **(60)** | (46) | (33) |
| Interest on obligation | **8** | 5 | 5 |
| Total charged to the result for year | **159** | 125 | 131 |

## 25. Pensions continued

### IAS 19 'Employee Benefits' continued

The movements in the net pension liability and the amount recognised in the balance sheet are as follows:

| | **2006 £'000** | 2005 £'000 | 2004 £'000 |
|---|---|---|---|
| Deficit at 1 January 2006 | **(243)** | (142) | (88) |
| Current service cost | **(151)** | (120) | (121) |
| Contributions | **80** | 115 | 121 |
| Past service costs | **—** | — | (5) |
| Other finance income | **8** | 5 | 5 |
| Actuarial loss | **(77)** | (101) | (54) |
| Deficit in scheme at end of year | **(383)** | (243) | (142) |

The principal actuarial assumptions at the balance sheet date are as follows:

| | **2006 %** | 2005 % | 2004 % |
|---|---|---|---|
| Rate of increase of salaries | **3.7** | 3.3 | 3.3 |
| Rate of increase for pensions in payment | **3.2** | 2.8 | 2.8 |
| Discount rate | **5.2** | 4.8 | 5.5 |
| Inflation | **3.2** | 2.8 | 2.8 |

## 26. Leasing commitments

Operating lease payments amounting to £4.98m (2005: £4.76m) are due within one year. The leases to which these relate expire as follows:

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Land and buildings £'000** | **Other £'000** | Land and buildings £'000 | Other £'000 |
| In one year or less | **115** | **941** | 35 | 191 |
| Between one and five years | **560** | **2,961** | 682 | 3,243 |
| In five years or more | **604** | **—** | 604 | — |
| | **1,279** | **3,902** | 1,321 | 3,434 |

## 27. Related party transactions

During the year the Group purchased financial and employment advice services from Premier Employee Solutions Limited, a company related by common directorship, of £39,000. At 31 December 2006 the Group owed £3,819 to Premier Employee Solutions Limited.

## 28. Subsequent events

On 5 March 2007 the Group announced a recommended offer for Careforce Group plc. The recommended offer is an expansion of the Group's public sector services into the community domiciliary care provision market.

# COMPANY ACCOUNTS

# REPORT OF THE INDEPENDENT AUDITORS – COMPANY

**To the members of Mears Group PLC**

We have audited the Parent Company financial statements of Mears Group PLC for the year ended 31 December 2006 which comprise the principal accounting policies, the balance sheet and notes 1 to 14. These Parent Company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Group financial statements of Mears Group PLC for the year ended 31 December 2006.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of Directors and auditors**

The Directors' responsibilities for preparing the Parent Company financial statements in accordance with United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities on page 19.

Our responsibility is to audit the Parent Company financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Parent Company financial statements give a true and fair view and whether the Parent Company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the Directors' Report is consistent with the Parent Company financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the Chairman's Statement, the Business Review, the corporate social responsibility and corporate governance information contained in the annual report and accounts and consider whether it is consistent with the audited Parent Company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Parent Company financial statements. Our responsibilities do not extend to any other information.

**Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Parent Company financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Parent Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Parent Company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Parent Company financial statements.

**Opinion**

In our opinion:

- the Parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs at 31 December 2006;
- the Parent Company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

**Grant Thornton UK LLP**
Registered Auditors
Chartered Accountants
Cheltenham
7 March 2007

# PRINCIPAL ACCOUNTING POLICIES – COMPANY

**Basis of preparation**

The financial statements have been prepared in accordance with applicable United Kingdom accounting standards and under the historical cost convention.

The principal accounting policies of the Company are set out below. Except as stated below, the following accounting policies have remained unchanged from the previous year and continue to be the most appropriate.

The Company has adopted the requirements of FRS 20 "Share-based Payments" in full in the current year. This change in accounting policy has resulted in a prior year adjustment. The impact of this is disclosed in note 4.

**Investments**

Investments are included at cost net of any provision for impairment.

**Share-based employee remuneration**

All share-based payment arrangements that were granted after 7 November 2002 are recognised in the financial statements.

The Group operates equity-settled share-based remuneration plans for its employees. All employee services received in exchange for the grant of any share-based remuneration are measured at their fair values. These are indirectly determined by reference to the fair value of the share options awarded. Their value is determined at the date of grant and is not subsequently remeasured unless the conditions on which the award was granted are modified. The fair value at the date of the grant is calculated using the Binomial Option pricing model and the cost is recognised on a straight-line basis over the vesting period. Adjustments are made to reflect expected and actual forfeitures during the vesting period to satisfy service conditions.

All share-based remuneration is ultimately recognised as an expense in the income statement with a corresponding credit to additional paid-in capital, net of deferred tax where applicable.

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

**Deferred taxation**

Deferred tax is recognised on all timing differences where the transactions or events that give the Company an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred by the balance sheet date. Deferred tax assets are recognised where it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the balance sheet date.

**Retirement benefits**

**Defined contribution pension scheme**

The pension costs charged against profits are the contributions payable to individual policies in respect of the accounting period.

**Financial instruments**

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

Income and expenditure arising on financial instruments is recognised on an accruals basis and credited or charged to the profit and loss account in the financial period to which it relates.

# PARENT COMPANY BALANCE SHEET

**As at 31 December 2006**

| | Note | 2006 £'000 | 2005 restated £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Investments | 5 | **16,918** | 12,440 |
| **Current assets** | | | |
| Debtors | 6 | **10,255** | 5,572 |
| Cash at bank and in hand | | **1,596** | 46 |
| | | **11,851** | 5,618 |
| **Creditors:** amounts falling due within one year | 7 | **(5,238)** | (1,802) |
| **Net current assets** | | **6,613** | 3,816 |
| **Total assets less current liabilities** | | **23,531** | 16,256 |
| **Creditors:** amounts falling due after more than one year | 8 | **(2,820)** | (600) |
| | | **20,711** | 15,656 |
| **Capital and reserves** | | | |
| Called up share capital | 9 | **615** | 588 |
| Share premium account | 10 | **5,547** | 3,960 |
| Shares to be issued | 10 | **1,485** | 1,040 |
| Profit and loss account | 10 | **13,064** | 10,068 |
| **Equity shareholders' funds** | | **20,711** | 15,656 |

The financial statements were approved by the Board of Directors on 7 March 2007.

**R Holt**
Director

**D J Robertson**
Director

The accompanying accounting policies and notes form an integral part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS – COMPANY

**As at 31 December 2006**

### 1. Profit for the financial year

The Parent Company has taken advantage of Section 230 of the Companies Act 1985 and has not included its own profit and loss account in these financial statements. The Group profit for the year includes a profit of £4.7m (2005: £4.4m) which is dealt with in the financial statements of the Company. This result is stated after charging auditors' remuneration of £38,000 relating to audit services and £20,000 relating to non-audit services.

### 2. Directors and employees

**Employee benefits expense**

All staff costs relate to Directors. Staff costs during the year were as follows:

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Wages and salaries | **947** | 932 |
| Social security costs | **121** | 102 |
| Other pension costs | **143** | 135 |
| | **1,211** | 1,169 |

The average number of employees of the Company during the year was:

| | 2006 Number | 2005 Number |
|---|---|---|
| Office and management | **4** | 3 |

Details relating to the remuneration in respect of the highest paid Director are detailed in note 4 of the notes to the consolidated financial statements.

### 3. Share-based employee remuneration

As at 31 December 2006 the Group maintained four share-based payment schemes for employee remuneration. The details of each scheme are included within note 5 to the consolidated financial statements.

All share-based employee remuneration will be settled in equity. The Group has no legal obligation to repurchase or settle the options.

In total, £0.1m of employee remuneration expense has been included in the Company's profit and loss account for 2006 (2005: £0.1m), which gave rise to additional paid-in capital. No liabilities were recognised due to share-based payment transactions.

### 4. Prior year adjustment

The Company adopted FRS 20 "Share-based Payment", effective for accounting periods beginning on or after 1 January 2006, in the current year. This standard requires that a value be attributed to share-based payments and that this be charged to the profit and loss account. Previously the cost of awards made under the Company's employee share schemes was based on the intrinsic value of the awards, with the exception of SAYE schemes for which no cost was recognised. A prior year adjustment has been made in the current year to reflect this change.

The effect of the change in accounting policy has been to decrease the operating profit and profit for the year in the preceding period by £0.1m.

### 5. Fixed asset investments

| Investment in subsidiary undertakings | £'000 |
|---|---|
| **Cost** | |
| At 1 January 2006 | 12,440 |
| Additions | 5,058 |
| Revision to previous acquisition | (580) |
| **At 31 December 2006** | **16,918** |

Additions relate to the purchase of the entire issued share capital of Laidlaw Scott as shown in note 22 to the consolidated financial statements.

The revision relates to the release of the deferred consideration on the previous acquisition of Powersave Limited. This contingent consideration was based on a multiple of future earnings. The Directors do not consider that any further monies will be payable in respect of this acquisition.

Details of the principal undertakings of the Company are shown in note 12 to the consolidated financial statements.

## 6. Debtors

| | 2006 £'000 | 2005 restated £'000 |
|---|---|---|
| Amounts owed by Group undertakings | **10,255** | 5,572 |

## 7. Creditors: amounts falling due within one year

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Corporation tax | **—** | 10 |
| Social security and other taxes | **36** | 133 |
| Amounts owed to Group undertakings | **5,025** | — |
| Other creditors | **—** | 1,316 |
| Accruals | **177** | 343 |
| | **5,238** | 1,802 |

## 8. Long term financial liabilities

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| Other creditors | **2,820** | 600 |

Included in Other creditors is deferred consideration of £2.82m (2005: £1.79m), of which £nil (2005: £1.19m) falls due within one year, relating to deferred consideration on the acquisition of Laidlaw Scott Limited. This is payable by a single instalment in April 2008.

### Interest rate risk

The Company finances its operations through a mixture of retained profits and bank borrowings.

The interest rate exposure of the financial liabilities of the Company as at 31 December 2006 was:

| | Interest rate | | | |
|---|---|---|---|---|
| | Fixed £'000 | Floating £'000 | Zero £'000 | Total £'000 |
| **Financial liabilities – 2006** | **—** | **—** | **2,820** | **2,820** |
| Financial liabilities – 2005 | — | — | 1,790 | 1,790 |

The bank overdraft facility is secured by a fixed and floating charge over the Group's assets.

## 9. Share capital

| | 2006 £'000 | 2005 £'000 |
|---|---|---|
| **Authorised** | | |
| 100,000,000 ordinary shares of 1p each | **1,000** | 1,000 |
| **Allotted, called up and fully paid** | | |
| 61,476,713 (2005: 58,828,199) ordinary shares of 1p each | **615** | 588 |

During the year 2,648,514 ordinary shares of 1p each were issued for consideration of £1.61m as a result of share options being exercised. The difference between the nominal value of £0.03m and the total consideration of £1.61m has been credited to the share premium account.

# NOTES TO THE FINANCIAL STATEMENTS – COMPANY

**As at 31 December 2006**

### 10. Share premium account and reserves

| | Share capital £'000 | Share premium account £'000 | Share-based payment reserve £'000 | Profit and loss account £'000 |
|---|---|---|---|---|
| At 1 January 2006 as originally stated | 588 | 3,960 | 90 | 10,285 |
| Prior year adjustment | — | — | 950 | (217) |
| At 1 January 2006 as restated | 588 | 3,960 | 1,040 | 10,068 |
| Issue of shares | 27 | 1,587 | — | — |
| Share option charges | — | — | 535 | — |
| Revision to previous year acquisition | — | — | (90) | — |
| Retained profit for the year | — | — | — | 2,996 |
| **At 31 December 2006** | **615** | **5,547** | **1,485** | **13,064** |

The revision to the valuation of options issued in respect of a prior year acquisition relates to an adjustment to the value of the Directors' best estimate of contingent consideration payable as detailed in note 5.

### 11. Capital commitments

The Company had no capital commitments at 31 December 2006 or at 31 December 2005.

### 12. Contingent liabilities

The Company had no contingent liabilities at 31 December 2006 or at 31 December 2005.

### 13. Pensions

**Defined contribution schemes**

The Company contributes to personal pension schemes of the Directors.

### 14. Subsequent events

On 5 March 2007 the Group announced a recommended offer for Careforce Group plc. The recommended offer is an expansion of the Group's public sector services into the community domiciliary care provision market.

Mears' commitment to environmental issues is reflected in this annual report which has been printed on Revive Silk, a recycled paper stock. It contains 75% de-inked post consumer waste and 25% combination mill broke and virgin fibres.

This document was printed by Beacon Press using their environmental print technology which minimises the impact of printing on the environment. All energy used comes from renewable sources, vegetable based inks have been used and 85% of all waste associated with this production has been recycled. The printer is a Carbon Neutral® company.

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