Mears Group PLC

Annual report and accounts 2012

# Continuing to lead, succeed and innovate

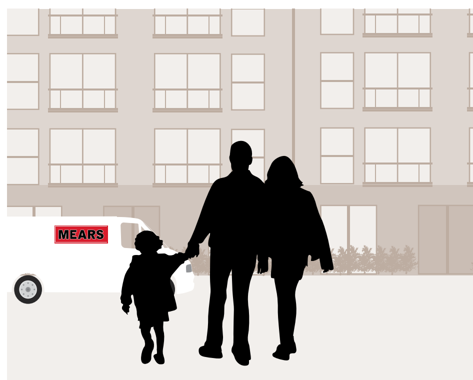
# …by responding to 25 years of change

**We maintain and improve homes as well as care for the people who live in them.**

Every day we carry out more than **6,000 repairs** to people's homes. We also deliver over **8 million hours of care every year** to vulnerable people, helping them to live in their own homes for longer.

## Our history

Mears began life in 1988 as a small, private building contractor. We entered the support services market in 1992 and after several key acquisitions, joined the London Stock Exchange Main Market in 2008. Mears today employs over 14,000 people across the UK. In partnership with our Social Housing clients, we maintain, repair and upgrade the homes of hundreds of thousands of people in communities from remote rural villages to large inner-city estates.




New contract biddings **pages 16 and 18**

Investing in people
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## Our vision

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

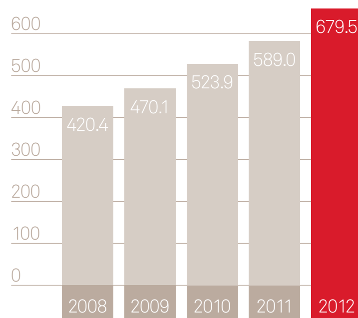
We do this by constantly striving to achieve the highest levels of customer satisfaction, efficiency and effectiveness in the social housing and home care services sectors.

Our approach is based on the development of outstanding partnerships with employees, clients, tenants, service users, their families and the wider community. Success enables us to create great opportunities for our employees and sustainable value for our shareholders.

# 2012 highlights

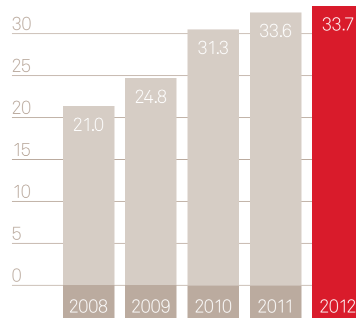
**Group revenue** (£m)

## £679.5m



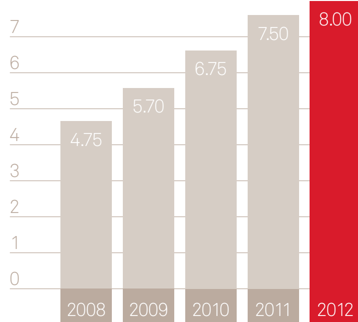

**Group operating profit** (£m)*

## £33.7m



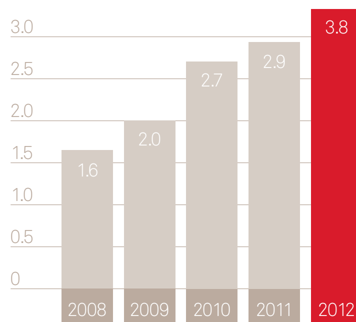

**Dividend per share** (p)

## 8.00p



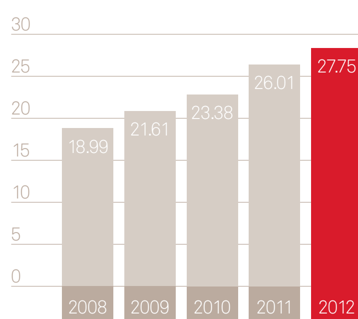

**Order book** (£bn)

## £3.8bn




**Diluted earnings per share** (p)**

## 27.75p




Key performance indicators
**pages 8–11**

Five-year record
**page 104**

* Before acquired intangible amortisation, exceptional costs and the trading loss of the recently acquired Morrison.

** Before acquired intangible amortisation, exceptional costs and the trading loss of the recently acquired Morrison with an adjustment to reflect a full tax charge.

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# 01 Why our business is sustainable

Our focus is on maintaining excellence in service delivery. This drives our increasing market share and strong financial output.

## Innovation, leadership and partnership

### We partner with the right people

Our success is built on strong, long-term partnerships with Local Authorities and Housing Associations, as well as with community groups, supply chain partners, staff and our investors.

#### A developmental approach

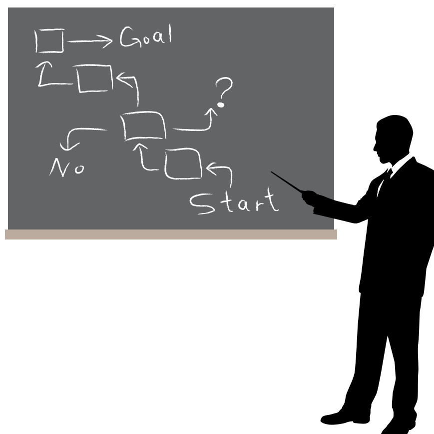
Our approach is based on the development of outstanding partnerships with employees, clients, tenants, service users, their families and the wider community. Success enables us to create great opportunities for our employees and sustainable value for our shareholders.

### We invest in innovation

We focus on long-term outcomes for people and invest in innovations that make a positive impact on their quality of life and on their communities' social, economical and environmental wellbeing.

#### Thought leadership

The challenges of delivering service improvements at lower costs require innovative thinking and extensive consultation between all stakeholders. Mears is unique in providing a range of services that help address some of the major challenges our country faces: quality social housing, building communities, caring for the vulnerable and sustainability.




### Our services are integrated

Mears today employs over 14,000 people across the UK. Health and wellbeing, socialisation and community integration and homes fit for purpose are all key elements in keeping people living happily, safely and securely at home.

#### Care and repair

Integrating our range of services brings distinct advantages: care services workers are uniquely placed to identify potential problems or hazards that could cause an accident and giving people direct access to a complete range of services enables preventative measures to be taken quickly.

**Repairs made every day**

**>6,000**

**Hours of care delivered per year**

**>8 million**

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## Our values

**We value our customers and communities**, putting the needs of our customers 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 services are targeted towards growing markets

Mears is uniquely placed to benefit from the expected growth in both our core markets of Social Housing and Care. As leaders in these sectors, we will continue to innovate both in improving service quality and in finding long-term value for money solutions.

### Our markets

**Social Housing**
With several growth drivers in Social Housing, including consolidation of Landlords and Housing Associations, this trend leads to increasing opportunities for organisations such as Mears.

Social Housing operating profit

**£24.0m**

**Care**
The future of care is very positive. Demographic changes mean 1.7m more adults will require care over the next 20 years. A key factor is the increasing role that the NHS is taking in joint commissioning.

Care operating profit

**£9.3m**

## We respond to change

**Our success in the past 25 years is down to an adaptable strategy that puts customers first, values quality leadership and benefits from our market-leading position.**

### Making a positive difference

Our purpose is to make a positive difference to the communities we serve. We do this by constantly striving to achieve the highest levels of customer satisfaction, efficiency and effectiveness in the social housing and care sectors.

Read our strategy in detail on **pages 6 and 7**

# 02 Uniquely placed in growing markets

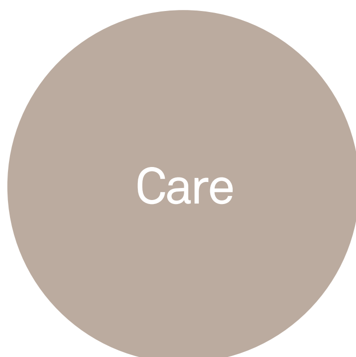
In the past 25 years we've grown to lead our markets and will continue to set ourselves apart from the competition through responding innovatively to opportunities.

## Social Housing growth drivers and opportunities

- Reduction in key competitors
- Rent increases and Housing Revenue Account reform
- Demand for social dwellings exceeds supply
- More homes being built
- Green refurbishments

## Growth drivers and opportunities affecting both markets

- Innovation
- Leadership
- Partnership




## Care growth drivers and opportunities

- Care at home is usually most cost effective
- NHS and Social Care integration
- Prevention agenda
- Outsourcing in-house services
- Importance of scale

Read more about our Strategy review on **pages 6 and 7**

## Our approach to Social Housing

Within Social Housing, opportunities for greater local investment in stock have been created by the reform of the Housing Revenue Account. The Government has also increased the incentives to build new stock to help address the huge backlog in demand for Social Homes. We have seen weakness in our direct competitors, which has helped improve our already good bid win rates, with an increasing demand from Social Landlords for innovative solutions given their financial pressures.

### We will continue to lead this sector through:

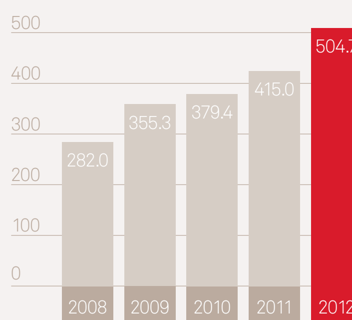
» Innovating our services around the customer, building on the 80% of tenants who already rate our service as excellent

» Making a positive contribution to local communities in terms of employment and training, tackling fuel poverty and building social inclusion

» Addressing new opportunities in the environmental space and, with Social Landlords, looking for new ways to meet the financial challenges facing them

**Social Housing revenue** (£m)

**£504.7m**




**Social Housing revenue** (%)
As a percentage of Group revenue

**74%**

## Our approach to Care

Within Care, we see opportunities in the planned reform of the health and social care system, in improved commissioning approaches and in the general consolidation of the market towards larger, more efficient suppliers. We believe the move towards personalisation plays to our service quality strength, as does the opportunity created by this for more integrated housing and care services.

### We will continue to lead this sector through:

» Integrating our Care and Social Housing services to give a unique and excellent service to vulnerable people

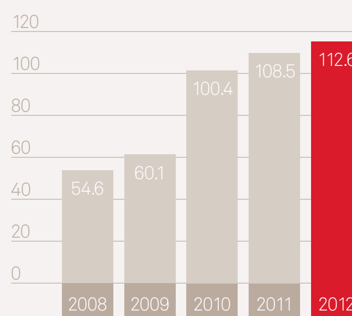
» Engaging with political stakeholders to ensure that policy creates opportunity to improve the service to the vulnerable

» Rolling out our new Care IT platform, which will improve the efficiency of our service delivery

» Maintaining our investment in the training and development of staff at all levels

**Care revenue** (£m)

**£112.6m**




**Care revenue** (%)
As a percentage of Group revenue

**17%**

# 03 Our strategic goals

We have a clear and effective strategy to strengthen and leverage our two existing growth platforms of Social Housing and Care.

## We respond to change through an adaptable strategy that puts service first for tenants first.

### Our mission

Our mission is to be the market leader in **transforming the social housing and domiciliary care services environment**, improving homes, improving neighbourhoods and **improving lives**.

More on how we measure our performance can be found on **pages 8 to 11**

## 1 Quality leadership

**What this means**

**Quality service yields competitive advantage**
The success of Mears is intrinsically linked to maintaining quality leadership in both our markets. For us, quality is a factor not only of direct customer satisfaction but also of the broader contributions we make to the communities in which we work.

**How we're doing it**

- Gaining external and internal recognition
- Creating trusted partnerships for the long term
- Being willing to share value
- Focusing on quality with sustainable margins
- Benchmarking ourselves versus other sectors as well as our own

**Our goals**

- To stretch our customer satisfaction target where 80% of tenants regard our service as excellent
- To exceed regulatory expectations within Care and Support as defined by Care Quality Commission (CQC)
- To have market-leading contract retention levels

**Key measures**

- Percentage of people rating service as excellent
- Customer complaints
- New contract bidding success rate
- Contract retention levels
- Jobs completed on time

Our strategy for the last 25 years, of delivering market-leading customer service to individuals and their communities, has been at the heart of our consistent track record of growth.

## 2 A customer-centric model

### Putting our residents first

All our services will be designed around the direct input of tenants and service users. Whether it's the services we offer or the training we give to staff, our first thought will be the needs of our customers.

- Continuing to deliver a Serving Communities plan in every locality in which we work
- Integrating our Care and Repair services
- Creating apprenticeships and work opportunities
- Putting residents at the front end of our service design

- To further develop our leading approach to Serving Communities
- To demonstrate and deliver the benefits of integrating Care and Repair services
- To build networks of residents across the country to ensure best practice is transferred to the benefit of all

**Customer satisfaction levels where our services are integrated**

**Number of community projects carried out**

**Number of apprenticeships and job experience opportunities**

**Levels of waste recycled**

**Accident frequency rate**

## 3 Market-leading performance

### Integrated in-house IT and financial management for optimum performance

Mears' robust and sustainable performance is built on a bedrock of first-rate, in-house developed IT management systems, robust financial controls and an experienced management team.

- Ensuring timely and focused key performance indicators (KPIs) management and reporting
- Providing a strong in-house IT development team giving market-leading IT capability
- Managing the supply chain through key partnerships
- Focusing on fast and efficient contact mobilisation capability

- To continue to establish our market-leading position
- To maintain our longstanding delivery on margin and cash
- To successfully roll out Mears' Care IT system
- To continue excellent compliance with regulatory frameworks

**Revenue growth**

**Operating margins**

**Profit to cash conversion**

**Normalised diluted earnings per share**

**Order book growth**

# 04 How we measure our performance

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

## Service delivery

**Our service delivery leads the market and we continue to improve.**

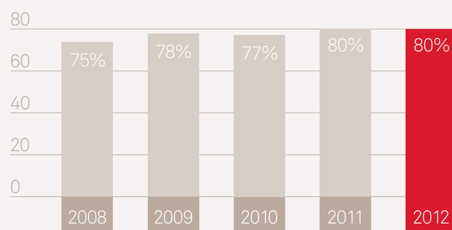
### Percentage of people rating our service as excellent

The sector in general collects customer satisfaction data and reports on the percentage of customers who rate the service as satisfactory. Given that we are service leaders, it is not sufficient to benchmark ourselves by these standards. Our measurement is based on the percentage of people who rate the service as excellent. We conduct around 80,000 surveys per year by phone and directly with the customer via our operatives' hand-held device (PDAs).

**Our aim for this year was**

>80%

**Outcome** 80%




**Our aim for next year is** >80%

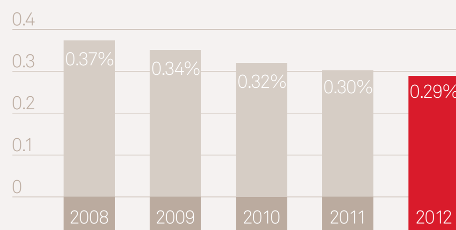
### Customer complaints

Whilst we achieve high levels of service excellence, it is important that we monitor carefully the number of poor service incidents, that we deal effectively with each individual complaint and that we learn from underlying trends. We measure the number of complaints as a percentage of repair jobs delivered in the period.

**Our aim for this year was**

<0.30%

**Outcome** 0.29%




**Our aim for next year is** <0.28%

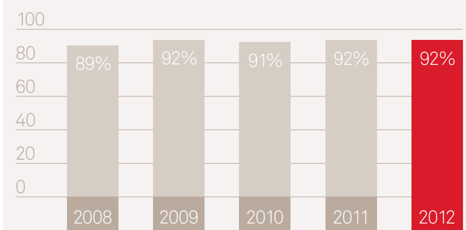
### Jobs completed on time

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

**Our aim for this year was**

>92%

**Outcome** 92%




**Our aim for next year is** >92%

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# Contract bidding

**We are recognised as being better, which drives our contract bidding success.**

## Social Housing new contract success rate

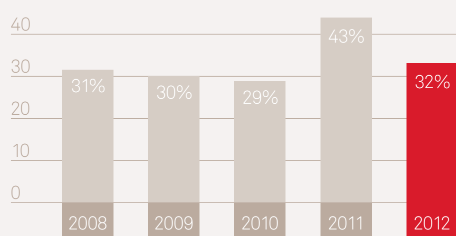
We tender £1–2bn of new opportunities each year. The average contract length is around six years in length. In order to achieve our organic growth forecasts, we monitor the proportion of new contracts secured as a proportion of total tendered works.

Included in this performance measure are contract retentions on re-bid. In addition, being awarded contracts from new customer relationships are key in order to achieve sustained growth.

**Our aim for this year was**

33%

**Outcome** 32%




**Our aim for next year is** 33%

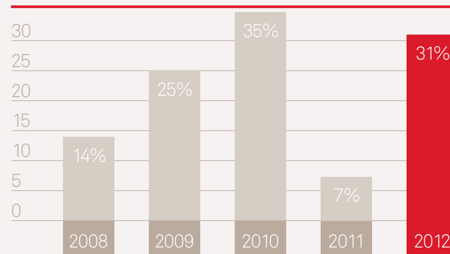
## Order book growth

We typically secure long-term contracts with our clients. Our Social Housing contracts average six years in duration and our Care contracts are typically shorter at around three years. Our order book includes an aggregate value of the future revenues that have been secured and will be delivered in future years. We only place a value against orders which are contractually secure and where the delivery of the works are highly probable. We do not include Social Housing framework arrangements within our order book as the value is considered uncertain. The order book valuation excludes indexation. The order book, which includes contract extensions, stretches to 2032. The order book growth in 2012 was enhanced by the transformational acquisition of Morrison which added around £0.9bn of secured orders.

**Our aim for this year was**

+10%

**Outcome** +31%




**Our aim for next year is** +10%

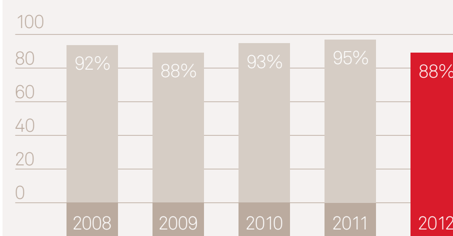
## Revenue secured

We typically secure long-term contracts with our clients, with Social Housing and Care contracts on average six years and three years in duration respectively. Typically there is a period of around three months between the notification of the award and commencement. It is therefore imperative that at the start of any financial year, a significant proportion of that year's orders are already secured. At 31 December 2012, our visibility of Social Housing revenues is 94%. However, the Group visibility has been significantly diluted by Other Services which has secured only 50% of its consensus forecast revenues for 2013.

**Our aim for this year was**

95%

**Outcome** 88%




**Our aim for next year is** 95%

# 04 How we measure our performance

Continued

## Financial outputs

**Our strong financial performance is a result of our differentiated service delivery.**

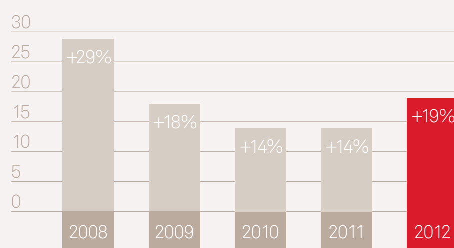
### Social Housing maintenance revenue – organic revenue growth

Revenue represents the amounts due for services provided during the year. In order to measure organic growth, we deduct revenue derived from assets that have been acquired. Whilst acquisitions form part of our growth aspirations in Social Housing, we believe that organic growth gives a better indication of business performance, as it is a purer aggregation of market growth, success in new contract bidding and contract retention. We also exclude the impact of revenues from the Decent Homes initiative as this area of the business is short term in nature. Our key focus continues to be our long-term, non-discretionary, maintenance revenues.

**Our aim for this year was**

+10%

**Outcome** +19%




**Our aim for next year is** +10%

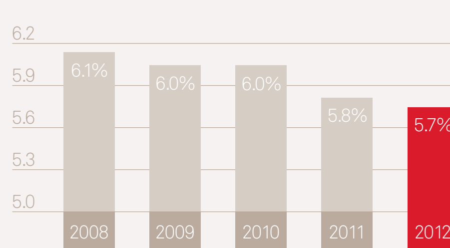
### Social Housing – operating margin

Social Housing operating margin gives a strong indication of profitability. We continually monitor our operating margin and manage our costs base to ensure that our services are delivered efficiently. Operating margin is struck before amortisation, share-based payment charges and exceptional items. We have consistently delivered a higher margin than our competitors. This has been due in part to being selective as to which new contract opportunities we tender. Our desire is to work with clients who focus on quality and value for money, and not simply the base price. The margin is also an indication as to the quality of our people and the quality of our systems.

**Our aim for this year was**

5.7%

**Outcome** 5.7%




**Our aim for next year is** 4.3%*

* A blend of 5.7% on the existing business, 1.0% on the acquired Morrison business.

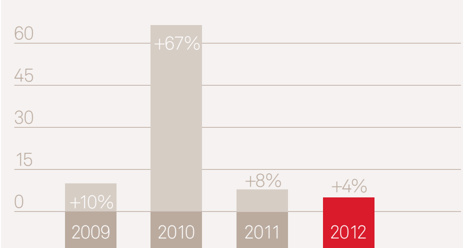
### Care – revenue growth

Revenue represents the amounts due for goods and services provided during the year. Our strategy in Care is to grow our existing business organically whilst making further strategic acquisitions to increase the services that we can offer to our clients. Our ambition is to be in a position to provide a complete solution for our service users. Typically, we look to acquire a small, regional operation that possesses a required specialism. We then look to use that acquisition as a platform to tender more contracts of this nature across the rest of the UK. We believe that the revenue growth and operating margin performance indicators cannot be considered singularly. It is a fine balance between growing the top line whilst maintaining our operating margin. Whilst revenue growth is a key performance measure, the quality of our service delivery and our operating margin will always take precedence.

**Our aim for this year was**

5%

**Outcome** +4%




**Our aim for next year is** +2%

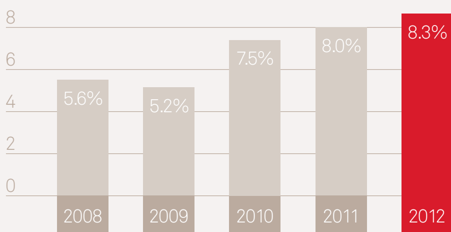
## Care – operating margin

The Care operating margin gives a strong indication of profitability. We continually monitor our operating margin and manage our costs base to ensure that our services are delivered efficiently. Operating margin is struck before amortisation, share-based payment charges and exceptional items. Care remains an environment where services continue to be purchased predominantly on price. We believe therefore that the revenue growth and operating margin performance indicators cannot be considered singularly. It is a fine balance between growing the top line whilst at all times protecting our operating margin. The acquisition of the Supported Living division of Choices Care provides the Group the capabilities to deliver more acute services that typically command a higher margin.

**Our aim for this year was**

8.0%

**Outcome** 8.3%




**Our aim for next year is** 8.0%

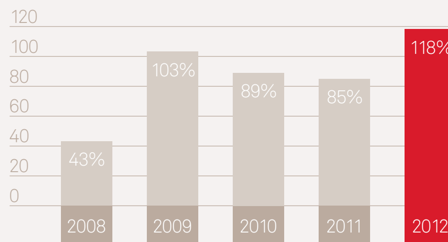
## Profit to cash conversion

The efficiency with which the Group manages working capital remains a cornerstone of our business. The Group closely monitors the conversion of profit into cash. The key measure is cash inflow from operating activities as a proportion of EBITA.

**Our aim for this year was**

80%

**Outcome** 118%




**Our aim for next year is** >80%

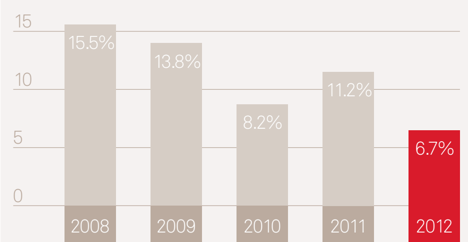
## Normalised diluted EPS

Normalised earnings are stated before exceptional costs and exclude the amortisation of acquisition intangibles together with an adjustment to reflect a full tax charge. We believe that a normalised diluted EPS measure gives a true assessment of operational performance, the analysis of trends over time, the comparison of different businesses and the projection of future performance. The number of shares in issue allows for the potentially diluting impact of outstanding share options.

**Our aim for this year was**

+8.0%

**Outcome** +6.7%




**Our aim for next year is** +7.0%

# A year of significant progress

## Mears identified significant strategic and operational synergy benefits from the acquisition of Morrison. The acquisition reinforces Mears' position as the leading Social Housing repairs and maintenance provider in the UK.

**Bob Holt** Chairman

## In summary

- The demand for our services continues to be very strong, with a bid pipeline in excess of £3.0bn, with immediate bidding opportunities for contracts due to start in the course of the next twelve months in the region of £1.7bn. Order book has increased to £3.8bn (2011: £2.9bn) driven by the transformational acquisition of Morrison.
- We enter the current year with visibility of 88% of the £900m consensus revenue forecast for 2013. Moreover, we have visibility over 66% of the £950m consensus revenue forecast for 2014 which demonstrates our strong position and the long-term nature of our business.
- We expect our Social Housing business to continue to grow through further contract wins, underpinned by our market-leading service delivery and, where appropriate, regional in-fill acquisitions.
- In our Care business, we will continue to move further up the acuity chain, principally through acquisition. This will increase our ability to respond to growing opportunities from health and social care outsourcing and the implementation of new localised commissioning models.

I am delighted to report record results with revenues of £679.5m (2011: £589.0m), including growth in Social Housing and Care of 22% and 4% respectively. Profit before tax prior to the inclusion of Morrison increased to £33.6m* (2011: £31.5m). The normalised diluted earnings per share on the same basis increased by 7% to 27.75p* (2011: 26.01p). The Board is recommending a final dividend of 5.70p per share (2011: 5.35p), making 8.00p per share for the year, an increase of 7%.

I am particularly pleased with our continuing strong working capital management with cash generated from operations as a proportion of EBITA amounting to 118% (2011: 85%). Cash management continues to be a key focus within the Group.

2012 saw the transformational acquisition of Morrison, our most significant Social Housing competitor. Mears identified significant strategic and operational synergy benefits from the acquisition of Morrison. The acquisition reinforces Mears' position as the leading Social Housing repairs and maintenance provider in the UK and sees the Group's order book increase to £3.8bn (2011: £2.9bn). Mears has an excellent track record in terms of service delivery and profitability and a strong track record of turning around, integrating and extracting substantial value from acquired businesses.

* Before acquired intangible amortisation, exceptional costs and the trading loss of the recently acquired Morrison.

**Group revenue**

**£679.5m**
**(2011: £589.0m)**

**Order book**

**£3.8bn**
**(2011: £2.9bn)**

In our Care business, the focus has been to balance delivering high quality service at sustainable margins with service innovation. In 2012, this approach continued to resonate with both our existing and new customers. Moreover, we are starting to see new contracts emerge which reflect the fundamental challenges in care. Whilst this evolution has been slower than we and many of our stakeholders would like, it does appear to have gathered momentum in 2012. Through the course of the year, we have been at the forefront of change in the sector and remain strategically well placed to take advantage of the current and long-term trends in care.

## Record order book

It should be remembered that Mears brought about a significant change in how social housing work is procured within a partnership arrangement. These partnerships now underpin an order book at £3.8bn. The demand for our services continues to be very strong, with a bid pipeline in excess of £3.0bn and with immediate bidding opportunities for contracts due to start within twelve months in the region of £1.7bn. We enter the current year with visibility of 88% of the £902m consensus revenue forecast for 2013. Moreover, we have visibility over 66% of the £955m consensus revenue forecast for 2014 which demonstrates our strong position and the long-term nature of our business.

We are well placed to benefit from the immediate bid pipeline and the wider contracting opportunities in our core markets. Our relationship with our customers continues to be strong and our partnering ethos is recognised and appreciated widely. We are delighted that customers choose Mears in awarding, as well as renewing, contracts to the Group across an array of activities.

## Committed employees

I commend our employees for their commitment and energy throughout another significant year for the Group. I continue to be impressed by the quality, professionalism and loyalty displayed by our people. We will return this commitment with appropriate investment in their development. Given we work in some of the most deprived communities in the UK, we take our responsibilities regarding employment extremely seriously.

We currently have almost 400 people enrolled in apprenticeship and job experience programmes within Mears. We are proud of the many practical and local opportunities we are able to create in these challenging times.

## Positive outlook

We operate in robust and defensive markets where spend is largely non-discretionary. We continue to place great emphasis on winning good quality contracts that can provide clear and sustainable margins, whilst at the same time providing a first class service and value offering for our clients. We will continue to differentiate ourselves through tenant-centric customer service and proposition innovations developed in partnership with our customers, combined with robust finances.

We expect our Social Housing business to continue to grow through further contract wins, underpinned by our market-leading service delivery and, where appropriate, regional in-fill acquisitions. In our Care business, we will continue to move further up the acuity chain, principally through acquisition. This will increase our ability to respond to growing opportunities from health and social care outsourcing and the implementation of new localised commissioning models. We will look to enhance and broaden our offering through partnerships and acquisitions.

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

**Bob Holt**
**Chairman**
bob.holt@mearsgroup.co.uk
9 April 2013

# Driving towards excellence

## Service quality remains our key differentiator. Whilst the Group is delighted at the strong performance delivered in terms of both new contract bidding and ultimately the financial outputs, it is important to remember that it is service quality that has always underpinned our success.

**David Miles** Chief Executive Officer

## In summary

### » Group

The acquisition of Morrison enhances Mears' order book in terms of both volumes and contract profile and strengthens our ability to secure larger tenders. Whilst the Morrison contracts are currently generating an operating loss, Mears has a strong track record of turning around, integrating and extracting substantial value from acquired businesses, along with an excellent track record in terms of service delivery and profitability.

### » Social Housing

The year has seen the most intense period of new contract mobilisation in the Group's history with the commencement of nine new social housing contracts. The mobilisation phase of each of these contracts is now complete.

### » Care

The Care division reported growth of 4% with revenues increasing to £112.5m (2011: £108.5m) and increased operating margins to 8.3% (2011: 8.0%). The growth in margin has been achieved through identifying and delivering additional synergies, together with a change in sales mix as the division delivers some higher acuity and higher margin services.

## Group performance

This has been another year of significant progress. We have seen the Group reinforce and further consolidate its market-leading position in the Social Housing sector with the transformational acquisition of Morrison, our most significant competitor. The acquisition of Morrison enhances Mears' order book in terms of both volumes and contract profile and strengthens our ability to secure larger tenders. The continued focus on providing first class, value for money customer service through our partnership ethos has ensured a better than expected retention rate on the acquired Morrison business as well as driving further new contract bidding success.

Morrison had encountered significant operational challenges having pursued an aggressive growth strategy at the expense of operating margin and service delivery. Whilst in aggregate the Morrison contracts that we acquired are currently generating an operating loss, we are making good progress in moving towards extracting value from these contracts. Mears has a strong track record of turning around, integrating and extracting substantial value from acquired businesses, along with an excellent track record in terms of service delivery and profitability. Mears identified significant strategic and operational synergy benefits from the acquisition of Morrison. The period since acquisition has seen a positive reaction to the transaction across the Morrison client base. We are now at an advanced stage in restructuring the senior operational management and social housing support functions. Whilst this has, as anticipated, realised significant financial synergies, it has also provided an opportunity to combine the strengths of both organisations and enhance operational delivery and control. Our operational, financial and development platforms are stronger than ever.

At Group level, revenues increased by 15% to £679.5m (2011: £589.0m), with organic growth being 7%. Operating profit before the acquisition of Morrison increased to £33.7m* (2011: £33.6m*) with operating margin reducing to 5.3%* (2011: 5.7%*), predominantly impacted by the operating losses of £1.6m (2011: profit £1.3m) of the Other Services division.

* Before acquired intangible amortisation, exceptional costs and share-based payments.

**Social Housing revenue**

**£504.7m**
**(2011: £415.0m)**

**Care revenue**

**£112.6m**
**(2011: £108.5m)**

"Mears has an excellent track record in terms of service delivery and profitability and a strong track record of turning around, integrating and extracting substantial value from acquired businesses."

## Divisional performance

| £m | 2012 Revenue | 2012 Operating profit* | 2012 Margin | 2011 Revenue | 2011 Operating profit* | 2011 Margin |
|---|---|---|---|---|---|---|
| Social Housing (excluding Morrison) | **459.7** | **26.3** | **5.7%** | 415.0 | 23.9 | 5.8% |
| Care | **112.6** | **9.3** | **8.3%** | 108.5 | 8.7 | 8.0% |
| Other Services | **62.3** | **(1.6)** | **(2.5%)** | 65.5 | 1.3 | 1.9% |
| Result before acquisition of Morrison | **634.5** | **34.0** | **5.4%** | 589.0 | 33.8 | 5.7% |
| Share-based payments | **—** | **(0.3)** | **—** | — | (0.2) | — |
| Acquisition – Morrison | **45.0** | **(2.3)** | **(5.1%)** | — | — | — |
| Total | **679.5** | **31.4** | **4.6%** | 589.0 | 33.6 | 5.7% |

* Before acquired intangible amortisation and exceptional costs.

### Social Housing

The 2012 financial year has seen the most intense period of new contract mobilisations in the Group's history with the commencement of nine new Social Housing contracts. Each mobilisation brought the additional challenge of a new customer relationship. The mobilisation phase of each of these contracts is now complete. Typically the Group anticipates a low margin from a new contract during its mobilisation phase, this being a time when it is critical that the necessary processes are put in place, whilst at the same time focusing on excellent customer service. Whilst these mobilisations gave a reduced margin in the first half of the year, operating margins bounced back in the second half of the year and the blended full-year margin was in line with normal levels.

The Social Housing business has continued to perform well. The Decent Homes programme is now substantially complete. Mears has seen over £90.0m of annualised Decent Homes revenues drop away over the last three years, with 2012 being the final drop-off with a reduction of £32.1m in revenues. Capital works, including Decent Homes, now contribute less than 10% of Social Housing revenues. It is pleasing that over the period in which the Decent Homes revenue has fallen away, the Group has successfully replaced this revenue with higher quality, non-discretionary maintenance revenues. Our core Social Housing maintenance operations reported organic growth of 19%.

| £m | Social Housing total | Core maintenance | Capital projects |
|---|---|---|---|
| 2011 revenue | 415.0 | 350.8 | 64.2 |
| Impact of acquisitions | 45.0 | 45.0 | — |
| Decent Homes expiry | (32.1) | — | (32.1) |
| Organic growth | 76.8 | 66.8 | 10.0 |
| **2012 revenue** | **504.7** | **462.6** | **42.1** |
| **Organic growth** | | **19%** | |

"We operate in robust and defensive markets where spend is largely non-discretionary. We continue to place great emphasis on winning good quality contracts that can provide clear and sustainable margins, whilst at the same time providing a first class service and value offering for our clients."

## Social Housing – new contract bidding

The Group has continued to experience significant success in winning new contracts. In Social Housing we have won 32% (by value) of all contracts bid, with a total value in excess of £380m. The most significant awards include:

### United Welsh

This award is a substantial strategic partnership with United Welsh for an initial period of eight years with an option to extend for a further seven years, valued at up to £145m over the 15-year period. The contract includes a wide range of services to the housing stock and estates covering eleven Local Authority regions in Wales. Services provided include responsive repairs, voids, gas servicing and breakdown, fire servicing and installation, grounds maintenance, cleaning and estate services. The contract is due to commence in April 2013 and represents the Group's second significant contract award in Wales over the last twelve months.

### Richmond Housing Partnership

A contract with Richmond Housing Partnership to provide responsive repairs, gas repairs and servicing, voids repairs and planned maintenance services to circa 8,700 properties. This award is particularly pleasing given that this is a renewal of our first material partnering contract awarded to the Group back in 2001. This demonstrates our success in renewing contracts with existing clients. The contract, which is for a five-year period with an option to extend for a further five years, is valued at £80m and will commence in April 2013.

### London Borough of Southwark

This is a significant contract with Southwark Council following the early termination with the incumbent contractor. This is for an initial one-year period to provide responsive repairs and void maintenance to over 20,000 properties within the London Borough of Southwark. This contract is valued at £11m and commenced in October 2012.

### Brunswick PFI

S4B, the Equitix-led partnership that includes Mears and Contour Homes, has been officially confirmed as preferred bidder for the Brunswick PFI social housing estate-based regeneration scheme which will involve the creation of a new residential neighbourhood in central Manchester. Mears will refurbish a further 653 homes and provide facilities management services under the project. The contract, which is expected to commence in June 2013, is valued at £70m.

## Divisional performance continued

**Social Housing** continued

The Social Housing bid pipeline remains robust which further supports our confidence that we can continue to deliver solid organic growth in both the short and medium term. The impact of the acquisition of Morrison added revenues of £45.0m. The Group has been delighted at the positive reaction of Morrison customers to the acquisition. Annual revenues from Morrison in the future are now anticipated to be in excess of £200m. The operating loss of £2.3m generated by Morrison in the period between 7 November 2012 and the year end was in line with expectations. The Group is optimistic that it can deliver synergies in excess of the £8.0m originally forecast as a result of combining the Social Housing divisional support functions. Furthermore, the Group anticipates increased profitability through enhanced operational delivery, migration to the Group's Social Housing IT platform and better procurement.

I am delighted that our Social Housing division continues to report improving service delivery notwithstanding the high standards already being achieved. The proportion of customers rating our service as excellent stands at 80% (2011: 80%). Typically others in the sector measure only satisfaction whereas our drive has always been for excellence. We have also seen the lowest ever level of complaints as a percentage of work carried out across all work types in the period, at 0.29% (2011: 0.30%). Service quality remains our key differentiator. Whilst the Group is delighted at the strong performance delivered in terms of both new contract bidding and ultimately the financial outputs, it is important to remember that it is service quality that has always underpinned our success. I want to particularly highlight that the Repairs and Maintenance arm of Mears became the first major private sector contractor in the housing industry to win the highly accredited Government Customer Service Excellence standard. The accreditation covers all of our Repairs and Maintenance branches in the UK.

**Service excellence***

**80%**
**(2011: 80%)**

**Customer complaints**

**0.29%**
**(2011: 0.30%)**

* Percentage of people rating Mears' service as excellent.

### Care

The Board is pleased with the performance of the Care division in terms of both the quality of service delivery and its strong financial performance. The Care division reported growth of 4% with revenues increasing to £112.6m (2011: £108.5m). This growth in Care revenues includes the full year impact of the acquisition of Choices Community Care (in administration) which came into the Group in August 2011. The underlying organic growth was 1%. We had 100% contract retention in 2012 and over half our new work was procured from new customers. At the same time, we increased our already impressive operating margin to 8.3% (2011: 8.0%), a tremendous achievement given that the Care sector remains a challenging environment. The growth in margin has been achieved through identifying and delivering additional synergies, together with a change in sales mix as the division delivers some higher acuity and higher margin services.

2012 has seen us respond to, and in some cases lead, industry change and service innovation. We have leveraged our Choices acquisition to address supported living work, for instance, helping people with learning disabilities. We have led the way on the development of the first care contracts where vendor payments are based on the quality of the outcome for the recipient rather than the quantum of the inputs; clearly, these arrangements favour a high quality, service-delivery focused business such as ours. This has been a key area of focus for Mears given our experience within Social Housing of this type of commissioning, which is much better suited to rewarding quality. Whilst still very much in the minority as a form of commissioning, it is pleasing to see that the door has now been opened. We have secured work directly from the NHS in 2012 in complex areas, such as coordinated hospital discharge programmes. This reflects the trend towards the joint commissioning of NHS and Local Authority services. We continue to believe that a market-leading approach to service quality and innovation through the application of technology puts the Group in a strong position.

Whilst the immediate budget pressures and structural change have stalled short-term market growth, we continue to see this sector as providing significant medium and long-term growth opportunities.

### Other Services

Mears' Other Services predominantly comprises its Mechanical & Electrical (M&E) operation. This division has experienced particularly challenging trading conditions during the second half of 2012 which show no signs of abating in 2013. The M&E environment is currently highly competitive and pricing is keen. The Group will not change its pricing model in response to the current challenges; instead the division is being downsized to match the orders currently secured. Notwithstanding this, the M&E pipeline continues to include a number of significant opportunities. The M&E division reported an operating loss of £1.6m (2011: profit £1.3m). Whilst the financial performance of the M&E division is disappointing, the Group is responding to these challenges to ensure that this division does not continue to trade at a loss for an extended period.

### Energy saving and environmental opportunities

The Government continues to look for solutions to tackle fuel poverty and carbon reduction challenges in housing. The flagship policy for this is the Green Deal, launched in January 2013, which includes a new Energy Company Obligation (ECO) to replace the existing CESP and CERT schemes.

January 2013 saw us completing one of the largest Fuel Poverty schemes in the UK within the Charlton Triangle in London. This £15m scheme has reduced the average fuel bill of a tenant by between £300 and £660 per year. Large schemes are also being conducted in Preston and Glasgow, where Mears has obtained funding for the benefit of our clients in these two cities.

We have already obtained the key accreditations needed for us to participate fully in this growing opportunity, particularly around ECO, and are forging strong relationships with energy providers to ensure our clients get the maximum benefit possible from this new funding source. Given our scale and reach, we are well placed to fulfil our ambition to become the leading provider of ECO-based solutions to the Social Housing sector.

## Sector developments

### Social Housing

In 2012 those Local Authorities which have retained their council housing function saw the finance of their operations being brought onto a similar footing to that of Housing Associations. This new decentralised decision making has put Local Authorities in the driving seat for determining the future of the direct local housing offer they can make to their communities. This may, in 2013 and beyond, lead to an increasing level of new housing. Housing Associations, together with the Government's Homes and Communities Agency, have been acclimatising to the new affordable rent regime. This hybrid rental approach, which bridges the social rent to private rent gap, is a challenge to their business plans. It is the private rental sector that currently promises to respond to the future housing needs of the country in the most flexible way. Mears will continue its active exploration of this dynamic area of the housing market, building on the arrangements we have in place servicing Fizzy Living, Thames Valley Housing's private renting programme.

Both Local Authorities and Housing Associations will be preparing for the impact of the Welfare Reform, which will in many cases change the relationship between tenants and landlords. We will be looking at how we can assist in making the new arrangements work for both parties. As in previous years we will be very careful with regards to which opportunities we pursue to ensure that we maintain our commitment to high quality, reliable services to both clients and tenants alike.

"We have led the way on the development of the first Care contracts where vendor payments are based on the quality of the outcome rather than the quantity of the inputs; clearly, these arrangements favour a high quality, service-delivery focused business like ours."

## New contract bidding – Care

In Care, contract bidding success rate (by value) of all contracts bid was 57% of all contracts bid, amounting to a total value of £63m, including:

### Cambridgeshire County Council

A strategic partnership to work alongside the Council to find new innovative ways to improve services. The contract term is five years with a potential for a further two-year extension. Over 30 providers are being removed from the Cambridgeshire Framework as part of this tender. Annual revenues with Cambridgeshire are expected to grow from £2m to £3m, with further upside potential.

### Stoke-on-Trent

A contract worth £2.4m over three years. This is a new client for Mears and one which was particularly impressed by Mears' integrated approach to housing and care as well as our innovative thinking around commissioning for outcomes. A new branch has been established in the City and we will use this as a hub for other emerging opportunities throughout the area including within housing.

### Brighton and Hove City Council

We have more than doubled our existing work in Brighton following a further contract win worth £3.7m over three years. This is an exciting opportunity given our strong housing presence in the City. We are joining up our service to provide a Care and Repair service to those people who live in Social Housing properties where we are also providing Care.

### Newham

This is a contract worth £4.1m over two years, with over 3,000 hours of care per week for independent living support services, providing personal support for adults including those with enhanced needs.

We have continued to develop our partnership thinking into new areas. Our work with Tunstall on the implementation of the largest telecare project in the UK has gone very well and is attracting interest from other councils, following the Government's stated intent to drive the use of assistive technology.

We have also secured a contract with Allianz Global Assistance who is looking to add Personal Care at Home onto Personal Accident Plans, so in the event of an accident, not only will the customer receive a cash pay out, they will also receive physical support with a Personal Care at Home package to support them through their rehabilitation period. Whilst we have not placed a value upon this within our order book, it is potentially a significant new opportunity.

## Sector developments continued

### Care

Across the Group we continue to see both the advantages of joined up service provision that pulls agencies and partners together across the health, care and housing sectors and the shortfalls when this approach is absent. We appreciate that the Governments, and many progressive agencies, share this objective but it is not yet a common reality.

The nature of our nation's ageing population means that the Government's role in the provision of care services will always be core to its success. There are currently 10,000 people aged over 100 in the UK. This figure is estimated to grow to in excess of 1m by 2070. Although this is recognised across the political spectrum we are still some way away from the new financial policy framework that the Dilnot review advocated in late 2010.

We are acutely aware that public spending is being necessarily constrained and that Local Authorities are in a tough position, faced with demand from their communities, yet having increasingly constrained resources. Despite this we have seen signs of real and active consideration of value for money, as opposed to just unit cost, through outcome-based care commissioning and we have witnessed the positive impact this has had on individual clients.

These enlightened approaches are still not commonplace. In this regard we were pleased to support the Local Government Information Unit (LGIU) on a joint study, published in the autumn, on this topic – Outcomes Matter: Effective Commissioning in Domiciliary Care. This research re-affirmed that although there is increasing awareness of the benefits of outcome focused care packages, day-to-day practices are still input dominated.

**Safety training delivered**

**19,000hrs**

**By SHE department**

**Jobs completed on time**

**92%**

**(2011: 92%)**

In these constrained times we expect Care and Repair services to become more valuable as they intervene early, are highly cost effective and are a simple and straightforward way of enabling vulnerable and older people to be assisted to either remain comfortably in their own homes or sensibly move to more appropriate housing.

An example of this approach is the innovative housing options service Mears delivers across Dorset in association with the County Council, the six District Councils and in partnership with the NHS and Adult Social Care. We provide support, information and advocacy to help people make an informed decision on their future accommodation needs. Should this result in them deciding not to move we can often help them to stay within their own homes by installing aids and adaptations to make their current home more manageable for the future.

### Safety, health and environment (SHE)

The year 2012 not only proved to be a safer year than 2011 but we also trained more operatives and managers, improved our recycling rates and reduced our waste costs. In 2012 we introduced new systems and procedures in response to new legislation and raised the KPI targets for all SHE staff. We achieved the RoSPA President's Award for ten consecutive gold medals. Whilst the number of employees increased, our accidents have reduced by around 8%.

Through our partnership with Network Waste, we have improved our recycling rates to over 90%.

Through development of in-house courses, not only are we now bringing more specific courses to our workforce but also reducing our training costs. We have continued to increase our focus on safety within our Care division thorough enhanced training together with new procedures and monitoring systems. Over the course of the year, the SHE department has delivered over 19,000 hours of safety training to both Mears' employees and clients' staff.

### Training and development

In 2012 we cemented our commitment to developing our people by establishing a new corporate learning and development strategy and central team. As we continue to grow, the strategy will ensure that best practice is shared across the business, that activity represents value for money and that we have in place structured plans that will support the needs and future growth of the Group.

We will continue to invest in the future generation of success. At the beginning of 2013, Mears employed almost 400 apprentices, boosted by the acquisition of Morrison. As the 2012 graduate trainees prepare to complete their programme, we have committed to a 2013 intake of high potential people who will benefit from two years of intensive development to prepare them for roles as future leaders of our business. In addition, our corporate strategy includes the establishment of an internal talent scheme which will recognise the potential of our existing workforce and maximise the retention of our most promising people.

We are delighted to have been awarded National Skills Academy Status by the Construction Industry Training Board in five regions of the UK. This will attract significant additional funding each year for three years through a programme of planned skills development. This includes supporting our supply chain to develop their capability to support the Group through formal qualifications and improved leadership and management skills. It also complements our existing comprehensive programme of community investment by recognising the value of work experience, apprenticeships and support for school and college students.

In early 2013 we will re-launch our technical training centre from a Welwyn base. The centre provides up-skilling across a wide range of trade disciplines in a cost-effective way, helping to increase productivity, quality and efficiency.

We are also introducing a 'Future Leaders Scheme' to encourage the stars of the future, whether they are graduates or non-graduates, to join the Mears family. They will spend time in various areas of the business and be mentored by existing leaders and this will form part of our commitment to succession planning and talent development within the Group.

### Our communities

We have operations throughout the UK and all our branches are dedicated to helping to improve people's lives. We work in some of the most socially deprived areas of the country and so we feel a strong sense of responsibility toward the wider community. Helping a community to thrive increases the quality of life for residents and supports community cohesion and development. Commitment to local communities is seen at every level of the organisation and during 2012 our staff volunteered over 22,000 hours and supported around 650 community projects across the UK.

**David Miles**
**Chief Executive Officer**
david.miles@mearsgroup.co.uk
9 April 2013

# Managing risk and financial control

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

**Andrew Smith** Finance Director

## In summary

» **Earnings**
The normalised diluted EPS, before the impact of the Morrison acquisition, increased by 7.7% to 27.75p (2011: 26.01p). The normalised diluted EPS after the impact of the Morrison acquisition increased to 26.06p (2011: 26.01p).

» **Dividend**
The Board remains confident in the future opportunities in its growth markets and consequently expects to be able to continue to follow a progressive dividend policy. The Board has recommended a dividend for the year of 8.00p (2011: 7.50p), a 6.7% increase.

» **Cash**
The efficiency with which the Group manages working capital remains a cornerstone of our business. The Group's conversion of operating profit to cash in the period was 118% (2011: 85%). During a period which has delivered significant organic growth, the cash performance has been outstanding.

### Financial performance

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

### Exceptional costs

Costs of £2.9m (2011: £3.1m) were considered to be non-recurring and exceptional in nature. Notably:

» During the year, the Group completed the acquisition of Morrison Facilities Services Limited. Transaction costs associated with this acquisition amounted to £0.8m and were expensed in the period. The costs relating to the acquisition would previously have been capitalised and included within goodwill.

» The Group incurred integration and restructuring costs of £2.0m relating to the acquisition. The Group identified significant synergies from the combination of two leading Social Housing maintenance providers. The majority of the efficiencies are expected to be generated from the combination of the two support service functions. The costs incurred relate to redundancy costs together with office closure costs. Given the acquisition was completed late in 2012, much of the cost of integration will be incurred in 2013. As previously signalled, we anticipate the final cost of integration across both years will be in the region of £8.0m.

### Amortisation of acquisition intangibles

A charge for amortisation of acquisition intangibles of £8.0m (2011: £7.8m) arose in the period. This charge relates to a number of acquisitions in both Social Housing and Care over the recent years. The acquisition of Morrison has resulted in the identification of acquisition intangibles of £20.3m. This resulted in a small increase in amortisation in the period given that the acquisition was completed late in the year. The charge in 2013 will increase significantly reflecting a full-year effect.

**Group revenue**

**£679.5m**
**(2011: £589.0m)**

## Net finance income/(charge)

Net finance income of £0.2m has been recognised in the year (2011: £2.1m charge).

The finance cost in respect of bank borrowings was £2.7m of which £2.6m related to existing activities (2011: £2.4m). Whilst the Group has provided debt funding to complete the acquisitions of Choices Community Care in August 2011 and Morrison Facilities Services in November 2012, together with the additional working capital required to fund the organic growth achieved during the period, it is pleasing that the average net debt has reduced to £57.0m (2011: £58.5m). Whilst the Group has reported a small increase in the cost of bank borrowing, this charge represents a positive variance of £0.5m to management's original forecasts and is reward for the strong working capital performance through the period.

The net finance income in respect of the defined benefit pension scheme was £3.0m of which £2.5m related to existing activities (2011: £0.3m). This income is broadly in line with expectations. The Group reported an income of £0.8m at the half year and this income has increased further during the second half year reflecting the increasing number of defined benefit pension schemes to which the Group is participating following the high number of new contract start-ups.

The finance cost in respect of bank borrowings was £0.1m and finance income in respect of defined benefit pension schemes was £0.5m in the period since 7 November 2012 relating to the acquired Morrison activities.

In 2013, with the adoption of the revised pension accounting standard (IAS 19R), the Group will be required to restate the 2012 Income Statement which will result in a reduction in the net finance income in respect of defined benefit pension schemes by £2.3m to £0.7m. The net finance income will reduce from £0.2m to a charge of £2.1m.

## Financial performance

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | **Existing £m** | **Acquired £m** | **Total £m** | Total £m | Change existing % | Change total % |
| Group revenue | **634.5** | **45.0** | **679.5** | 589.0 | +8% | +15% |
| Operating profit before exceptional costs* | **33.7** | **(2.3)** | **31.4** | 33.6 | — | (6%) |
| Profit before tax and before exceptional costs* | **33.6** | **(1.9)** | **31.7** | 31.5 | +7% | +1% |
| Profit before tax* | **33.6** | **(4.8)** | **28.8** | 28.4 | +18% | +1% |

* Pre amortisation of acquisition intangibles.

## Earnings per share (EPS)

| | **2012 p** | 2011 p | Change % |
|---|---|---|---|
| Normalised diluted earnings per share before the losses generated from the Morrison acquisition* | **27.75** | 26.01 | +6.7% |
| Normalised diluted earnings per share* | **26.06** | 26.01 | — |
| Dividend per share** | **8.00** | 7.50 | +6.7% |

* Before exceptional costs and pre amortisation of acquisition intangibles and based on a normalised tax charge of 24.5%.

** Including a proposed final dividend of 5.70p per share.

## Cash performance

| | **2012 £m** | 2011 £m |
|---|---|---|
| Operating profit before amortisation | **28.6** | 30.5 |
| Costs of acquisition | **0.8** | — |
| Exceptional costs with no 2012 cash impact | **1.9** | — |
| Adjusted EBITA | **31.3** | 30.5 |
| Cash inflow from operating activities before taxation | **37.1** | 25.9 |
| Cash conversion | **118%** | 85% |
| Net debt at balance sheet date | **12.4** | 13.4 |
| Average daily net debt | **57.0** | 58.5 |

## Balance sheet

| | **2012 £m** | 2011 £m |
|---|---|---|
| Goodwill and Intangible assets | **163.6** | 127.5 |
| Property, plant and equipment | **16.0** | 12.7 |
| Inventories | **11.8** | 12.5 |
| Trade receivables | **183.1** | 127.5 |
| Trade payables | **(199.0)** | (105.0) |
| Net debt | **(12.4)** | (13.4) |
| Deferred consideration | **(1.3)** | (0.9) |
| Cash flow hedge | **(2.5)** | (1.7) |
| Pension | **6.4** | (5.8) |
| Taxation | **3.1** | (0.6) |
| Net assets | **168.8** | 151.8 |

"The Board remains confident in the future opportunities in its growth markets and consequently expects to be able to continue to follow a progressive dividend policy".

## Tax expense

A tax charge of £1.5m has been provided (2011: £3.7m). The effective current corporation tax rate recognised in the Income Statement before adjustments for deferred tax is 15.3% (2011: 22.1%). The effective current corporation tax rate is significantly lower than the headline rate due to a deferred tax credit in respect of the amortisation of acquisition intangibles of £1.1m, a non-taxable pension benefit of £3.0m and a corporation tax deduction in respect of the exercise of share options of £7.5m.

## Earnings per share (EPS)

The normalised diluted EPS, which allows for the potential diluting impact of outstanding share options, before the impact of the Morrison acquisition, increased by 6.7% to 27.75p (2011: 26.01p). The normalised diluted EPS after the impact of the Morrison acquisition increased to 26.06p (2011: 26.01p). Normalised earnings are stated before exceptional costs and exclude the amortisation of acquisition intangibles together with an adjustment to reflect a full tax charge of 24.5% (2011: 26.5%). We believe that this normalised diluted EPS measure better allows the assessment of operational performance, the analysis of trends over time, the comparison of different businesses and the projection of future performance.

## Acquisitions and intangible assets

The value of goodwill and other identified intangibles carried within the balance sheet is £163.6m (2011: £127.5m). The significant increase during the period was as a result of the acquisition of Morrison with consideration of £24.0m being paid in return for tangible net liabilities of £14.6m. The Morrison intangible asset was recognised, net of deferred tax, at £15.6m with the remaining excess of £23.1m recognised within goodwill. A balance of £8.0m (2011: £7.8m) of amortisation was charged to the Income Statement during the period.

### Acquisitions

Mears acquired 100% of the share capital of Morrison Facilities Services Limited (Morrison) from Morrison plc, a subsidiary of Anglian Water Group Limited (AWG) for a total consideration of £24.0m of which £16.0m was funded by cash and the balance of £8.0m through the issue of 2,833,489 shares. AWG has undertaken not to dispose of the new Mears shares before 7 November 2013.

Morrison provides repairs and maintenance services to social housing clients in England and Scotland.

For the year ended 31 March 2012, Morrison reported turnover of £290.9m and an operating loss, before exceptional costs, of £7.6m. Prior to the acquisition, Morrison had completed a restructure and exited a number of mainly loss-making contracts which reduced the operating loss. Mears has identified a total of £8.0m of synergies, the majority of which it would expect to achieve during the 2013 financial year and the balance during 2014. In order to achieve these synergies, it is expected to incur around £8.0m of one-off restructuring. These synergies are largely derived from overlapping operational support services.

## Dividend policy

The Board remains confident in the future opportunities in its growth markets and consequently expects to be able to continue to follow a progressive dividend policy. The Board has recommended a final dividend of 5.70p per share which, combined with the interim dividend, gives a total dividend for the year of 8.00p (2011: 7.50p), a 6.7% increase. The dividend is payable on 2 July 2013 to shareholders on the register on 14 June 2013. The dividend is covered 3.25 times by normalised diluted earnings per share.

## Cash performance

The efficiency with which the Group manages working capital remains a cornerstone of our business. The Group's conversion of operating profit for the year before tax and pre amortisation to cash in the period was 118% (2011: 85%). The Group has consistently set high standards of working capital management and high levels of conversion of profit into cash. During a period which has delivered significant organic growth, the cash performance has been excellent.

Our net debt position at 31 December 2012 was £12.4m (2011: £13.4m). Whilst the year end cash position was pleasing, typically the accounting period end reports a low debt balance when compared to the rest of the year. A far more important metric is the Group's daily net debt balances which provide a better indication of working capital management. The average net debt over the year, adjusted for the impact of Morrison, amounted to £57.0m (2011: £58.5m). The acquisition of Morrison utilised £16m in respect of consideration and a further £4m in respect of working capital. Given the timing of the non-trading outflows, a better indicator of core debt at the year end is in the region of £75m (2011: £60m). We have always been and remain conservative in respect of our appetite for debt.

**Diluted earnings per share***

**27.75p**
**(2011: 26.01p)**

* Before acquired intangible amortisation, exceptions costs and the trading loss of the recently acquired Morrison and adjusted to reflect a full tax charge.

**Dividend per share***

**8.00p**
**(2011: 7.50p)**

* Including a proposed final dividend of 5.70p per share.

**Group operating profit***

**£33.7m**
**(2011: £33.6m)**

* Before acquired intangible amortisation, exceptional costs, share-based payments and the trading loss of the recently acquired Morrison.

## Pensions

| | 2012 £m | 2011 £m |
|---|---|---|
| Pension asset | **14.0** | — |
| Pension liability | **(5.7)** | (5.8) |
| Net asset/(liability) | **8.3** | (5.8) |

**Cash conversion (EBITA)**

**118%**
**(2011: 85%)**

The Group has a £120m unsecured revolving credit facility and an additional accordion mechanism allowing the facility to be increased to a maximum of £160m. This facility, which runs to July 2016, provides sufficient funding headroom for the Group. The Group continues to enjoy a strong relationship with both its bankers, Barclays and HSBC.

## Other trading balances

The Group capital expenditure of £3.9m (2011: £4.0m) relates to IT hardware, other office equipment and the refurbishment of new office premises. Predominantly, all our plant and machinery is hired and motor vehicles are subject to operating leases and hence are not included within capital expenditure or recognised as an asset within the balance sheet. In addition, development expenditure was incurred in developing the in-house IT platform of £1.1m (2011: £1.4m).

A balance of £2.8m (2011: £2.4m) is included within non-current trade and other receivables. This relates to sales retentions in relation to our M&E activities within our Other Services division. This is normal practice within that sector, where a small percentage of the contract sum is withheld for a short period. This is typically settled twelve months after the completion of works.

Trade receivables and inventories increased to £194.9m (2011: £140.0m) and trade payables have increased to £199.0m (2011: £105.9m). Both these increases are driven predominantly by the acquisition of Morrison. Excluding the impact of Morrison, trade receivables and trade payables increased by 8% and 12% respectively which have increased as a result of organic growth achieved by the Group.

Total shareholders' equity rose by £17.0m to £168.8m at 31 December 2012. The increase in net assets is the result of a combination of retained profits together with the issue of 3.4m shares on the exercise of share options and a further 2.8m shares to part-fund the acquisition of Morrison.

## Pensions

The Group participates in two principal Group pension schemes (2011: one) together with a further 28 (2011: 14) individual defined benefit schemes where the Group has received Admitted Body Status in a Local Government Pension Scheme. At the point of tendering for new contract opportunities, the Group seeks to minimise its exposure to future changes in the required pension contribution rates and to future liabilities resulting from scheme deficits.

The increase in the asset in respect of the defined benefit pension schemes relates to the asset acquired as a result of the acquisition of Morrison Facilities Services Limited. The IAS 19 actuarial valuations for the other schemes as at 31 December 2012 reported a reduction in the pension liability by £0.1m.

The Group continues to comply with a repayment plan with the trustees of the Mears Group scheme at £0.9m per annum for a period of nine years with a view to the scheme being fully funded by 2020.

## Corporate governance

Mears has reported strong growth over its 17 years as a listed company. Fundamental to this success has been our ability to identify and manage both risks and opportunities in a constantly changing environment. Over the course of 2012, significant resource has been directed towards corporate governance, with particular focus being given to significantly enhancing the Group risk management process that will ensure a uniform approach across all our business to identify and mitigate risk.

**Andrew Smith**
**Finance Director**
andrew.smith@mearsgroup.co.uk
9 April 2013

# Robust risk management

## The effective management of risks is a key feature in the continuing success of the Mears Group. Our approach is to identify principal risks and robustly mitigate the impact of these risks through a Group risk management process.

| Risk and description | Mitigation |
|---|---|
| **Macroeconomy**<br>Mears' primary markets are subject to Government legislation and are dependent on the political environment, local or national, including public sector policy and funding.<br>Any changes in policy or legislation that reduce expenditure during the life of contracts could have a detrimental effect on the Company's business. Also other market factors could damage business, e.g. economic failures and stock levels. | » Awareness of and responsiveness to market developments, e.g. developing managed in-sourcing and joint venture products to give choice to clients<br>» Business strategy – diversity of markets expanding from the original Social Housing sector business<br>» Innovation around Government policy<br>» Pensions policy to limit liability |
| **People**<br>Mears is dependent on the management team along with a skilled and motivated workforce, otherwise the delivery of business objectives will be jeopardised.<br>Mears sees sound commercial management of contracts and the business as a whole as essential to our objectives.<br>Management expertise is retained to maintain the right balance between our customer-centric culture and our commercial requirements. We always want to provide value for money as well as legitimately bill our clients and at the same time achieve operating efficiency drawing from best practice. | » New Group Learning & Development strategy with a strong central team<br>» Recruitment and selection criteria for all appointments<br>» High quality people to be secured and retained in key positions<br>» Training programmes supplied and we have Investor in People certification<br>» Formal assessment/capability testing for key management appointments<br>» Succession planning for key positions<br>» Expanded the Group's Senior Management Team to cope with existing and new business<br>» Business unit budgets and regular monitoring of profit and loss performance and cash conversion<br>» Risk mitigation plans showing Group, branch and regional lines of defence |
| **Reputation**<br>The ultimate success of Mears relies upon maintaining a positive reputation in the public and amongst all stakeholders.<br>Negative actions, behaviour, service and results will damage the business' reputation and will affect the future of Mears. This includes risk of negative publicity from actions of employees and suppliers.<br>This could arise, amongst other reasons, from inappropriate communications, inaccurate client reporting or poor care and poor attention to vulnerable customers. | » Strengthened corporate governance<br>» Clear communications policy and strategy with a new Group Scheme of Delegated Authority, Daily Mears Matters news email and quarterly top 80 managers' meetings, which are cascaded to all employees.<br>» Internal auditing of KPI reporting<br>» Care risk plan for dealing with vulnerable customers<br>» Comprehensive health and safety policy and safe systems of working<br>» Compliance management of bribery and corruption legislation, whistleblowing policy, internal audit resources<br>» Upgrading of Group Fraud Risk Management Plan and anti-fraud policy |
| **Liquidity**<br>There is a noticeable increase in client and market focus in the financial strength of the companies trading within the Group's core business sectors due to a number of main peer contractors going into liquidation.<br>Various stakeholders require reassurance that the Company has strong liquidity risk management including a long-term funding facility and the generation of sufficient cash from trading. Risks arise from short-term cash flow movements and renewal risk on maturity of facilities. | » New funding facility secured in 2011 to service the Group's needs until 2016, target refinance one year before maturity<br>» Business unit budgets and regular monitoring of financial performance<br>» Long-term liquidity – annual cash flow forecasts for visibility of funding and compliance with banking covenants<br>» Short-term liquidity – weekly three-month rolling cash flow forecast and detailed variance analysis<br>» Robust management of work in progress and debt<br>» Proactive identification of potential bad debt and management plans put in place between operations and finance teams |

| Risk and description | Mitigation |
|---|---|
| **Health and safety**<br>Mears' services and operations involve a series of high risk activities ranging from dealing with vulnerable customers in need of care to our building related services, e.g. working at heights, working with gas and electricity and dealing with asbestos. Failure to have robust and safe systems of work could lead to serious personal injury or fatality. | » Strong Group and regional safety, health and environmental (SHE) teams<br>» Comprehensive safe systems of work and risk mitigation plans<br>» Internal SHE auditing and third party external validation<br>» Regular SHE communication and a national conference<br>» Training of operations staff and the involvement of subcontractors<br>» Annual Group SHE strategy and plan<br>» Close involvement with regional and branch management |
| **Business retention and new business**<br>A strong bid pipeline and order book are both essential to the success of the business.<br>Risk management planning is needed to ensure new tenders are won and existing contracts are retained. Successful re-tendering requires a combination of competitive pricing and client confidence in quality proposals based on evidence of historical delivery. | » Strong Group Business Development team<br>» Bid project management process with assigned bid leader<br>» Expanding bid governance process under consolidated scheme of delegated authority, including audits<br>» Risk plan to respond to sub-optimal market pricing<br>» Commercial review of efficiency of delivery model for re-tendering and a plan to achieve best efficiency rates<br>» Regional Managing Directors' performance review and client/management relationships<br>» Contract development/improvement plans |
| **Business continuity**<br>Mears recognises that there are considerable risks of business continuity in certain locations within our markets which could be caused by rioting, terrorism and natural catastrophe. In addition there are geographical risks that could threaten our business infrastructure, e.g. telecommunications failures.<br>Vulnerable people depend upon our services; hence we must have disaster recovery and business continuity plans. | » IT disaster recovery plan and back-up systems facility remote to business units<br>» Business continuity plans for each regional/business unit in progress<br>» Disaster scenario management training<br>» Data back-up facility and protocol<br>» Disaster recovery and business continuity plans to be tested annually |
| **Legal and regulatory**<br>The Group is subject to numerous tax, legal and regulatory requirements.<br>A breach of any of these could result in legal proceedings, imposition of financial and other penalties or investigations, taking management focus away from core business and therefore disrupting the business. | » Provision of information across the business about new laws and regulations<br>» Head of Legal Services remit with an expanded team and external support<br>» Induction of staff<br>» Training of key staff on developments including the Bribery Act 2010<br>» Policies and procedures issued and controls to comply with laws and regulations<br>» Risk assessments<br>» Internal governance control and audits |
| **Integrity, ethics, anti-bribery and corruption**<br>There are inherent risks of bribery, fraud and corruption in some of the sectors we work in. It is important that we have an internal control framework and means of communication to be proactive where any risks materialise. | » Group internal audit team<br>» Confidential whistleblowing policy<br>» Regular communication of Company policy<br>» Comprehensive investigations and robust action on any negative findings<br>» Business ethics code of conduct<br>» Auditing of legitimate work valuation/billing from subcontractors and to our clients<br>» Risk plan to implement controls for the anti-bribery and anti-corruption legislation |
| **Operational risk**<br>The success of the Group is underpinned by the delivery of services profitably whilst exceeding our clients' expectations and our contractual obligations. | » Senior Directors to attend a significant proportion of client and tenant group meetings to ensure there is no disconnect between our customer experience and other management information<br>» Each division has its own risk register and subject to Group risk audit<br>» A number of the key mitigants are covered within People and Health and Safety on page 24 and above respectively<br>» Ensuring robust processes are put in place to control the procurement and management of subcontracting<br>» The Group's IT systems have been developed to ensure maximum visibility of labour productivity and gross margin<br>» Business unit budgets and regular monitoring of profit and loss performance and cash conversion<br>» Any major contract failures relating to operations or commercial results are managed and improved by operating companies with Group support and scrutiny |

# Driving sustainable business growth

## As our business grows our capacity to support individuals and communities, develop our workforce, protect the environment and influence business practices also grows. Our bulging award cabinet testifies of our achievements to date but more importantly our clients, customers and staff recognise the positive and ongoing contribution that we make.

### Putting customers and communities first

We believe that the most important aspect for a sustainable business is to continually focus on the needs of customers. The Repairs and Maintenance arm of Mears Group PLC became the first major private sector contractor in the housing industry to win the highly credited Government Customer Service Excellence standard. The accreditation covers all of our Repairs and Maintenance branches in the UK and sees Mears joining a select group of public sector organisations in the UK to hold the accreditation.

Commitment to local communities is seen at every level of the organisation and during 2012 our staff volunteered over 22,353 hours and supported 648 community projects across the UK.

We also delivered 35 days of training on DIY and home maintenance to tenants and residents enabling them to fix issues that are deemed their responsibility and helps improve the condition of their homes.

Our commitment to communities sets us apart and we believe this is just one of the reasons that during 2012 we retained 100% of our clients.

### Developing a great workforce

Mears has once again retained its Investors in People accreditation (IIP). We have held this accreditation since 1994 and we continue to actively seek feedback and listen to our staff. Following feedback from our 2011 staff survey, we began a programme of initiatives designed to improve communications around the Group.

Our Internal Communication programme, 'Inside Matters', aims to create a better communication environment where Mears people know their opinions matter; have access to channels to express their views; can more easily share information and ideas; and are encouraged to respond to Group and local matters.

During 2012 we introduced a daily news snippet emailed to everyone with a Mears address and have made significant improvements to the intranet, which can now be accessed by all staff logging in from home or public computers.

The impact of this work, which also included numerous face to face briefings and workshops, has significantly improved how our employees see our business. We recognise the importance of families too. Some 7,000 employees and their families attended our two Family Fun days in England and Scotland in 2012.

During 2012 we continued our commitment to apprentices with 100 new recruits. Importantly the Group has been able to retain 87% of apprentices and trainees who completed their level 2 training programme. This is a statistic which is well ahead of the industry norm. We currently have 268 apprentices and trainees in our Repair and Maintenance business. A similar programme has been launched in our Care business.

Mears now has training centres in Welwyn, Peterborough, Rotherham and Birmingham. The centres deliver training across a range of trade disciplines in a relaxed environment. All training is customised to meet the needs of the learners. A particular focus is on supporting employees to develop skills that complement their existing specialism with the aim of increasing first time fix, reducing follow-on appointments and increasing customer satisfaction. Training is also available for employees who are not tradespeople but would benefit from basic home maintenance knowledge. We also run community training programmes which provide taster sessions for local residents, work experience for young people and the unemployed and short courses in home maintenance skills.

2012 also saw the introduction of a new Code of Conduct for all employees and a new Scheme of Delegated Authority (SODA), to provide absolute clarity to staff on decision making and financial control within the Group.

### Protecting the environment and tackling fuel poverty

In 2012, Mears can again report continued improvements in its environmental performance. Our partnership with Network Waste has helped Mears to achieve 90% recycling rates and, even when faced with two waste industry increases in 2012, we have managed to reduce the amount we spend on waste management by good housekeeping. In order to achieve this we have invested in new compactors to reduce the cost of waste transportation, renegotiated costs with suppliers and implemented better waste management processes.

During 2012 we have developed a closer working relationship with our subcontractors where we have assessed how they manage the process of waste management. We are now able to report on their recycling performance through the online reporting system administered by Network Waste.

We know that climate change is an issue that can only be tackled in partnership. Throughout 2012, Mears Energy has been advising clients on the measures they can take to reduce carbon emissions, for example our work with Family Mosaic and Charlton Triangle Homes to deliver the Charlton Homes Energy Saving Project, the largest energy efficiency refurbishment project for social housing in the UK. On average tenant fuel bills have been reduced between £300 and £600 per annum as a result of this work.

We recognise the importance of measuring and addressing our own carbon footprint and we have a clear plan in place to mitigate against it.

### Responsible business leaders

Providing our employees with a safe working environment is paramount. We have reduced our Accident Frequency Rates by 15% through increased awareness training and site inspections. Mears' commitment to health and safety has been recognised by the Royal Society for the Prevention of Accidents who awarded us the President's Award for gaining ten consecutive Gold Medals. Despite this outstanding record during 2012 we carried out 19,029 hours of health and safety training of which over 80% was delivered in-house.

As a major player in the housing sector, we believe we have a responsibility to develop local economies. Our commitment to Small And Medium Enterprises (SME) therefore goes beyond that of a traditional main contractor. We understand that many of these businesses are sole traders or small enterprises, where the owners are often 'on the tools' and as such cannot always spend

the time on back office functions. That's why we have set up local SME Business Clubs, helping SMEs grow their businesses.

## Driving positive change

Mears is unique in providing a range of services that help address some of the major challenges our country faces; social housing and care for older and disabled people and environmental sustainability. We are committed to sharing innovation and best practice, which is why we have developed the Mears Thought Leader programme. Thought Leader engages with the UK's leading policy makers and practitioners to develop solutions and challenge conventional thinking.

During 2012, the Thought Leader programme has enabled Mears to shape the debate on a wide range of issues including social mobility, fuel poverty, tackling loneliness, the social value of housing and the role of advice services.

Mears has gained particular recognition for its work on social care commissioning practices. Working in partnership with the think tank LGIU, 'Outcomes Matters', a report focusing on commissioning for outcomes, was published in October 2012 with input from over 100 Local Authorities.

In response to our report, Norman Lamb MP, Minister for Care Services, commented, "I am determined that collectively we develop commissioning skills so that providers are rewarded for improving health and wellbeing, promoting independence and increasing mobility."

Mears' role as a Thought Leader was also recognised when we were selected as a case study in the Department of Health's White Paper on Social Care. We were also proud to be selected as a one of five leading businesses tackling barriers to social mobility to be featured in a Cabinet Office Film which was launched by the Deputy Prime Minister, Nick Clegg MP.

## Continually focusing on the needs of customers

"Partnering with Mears has really added value where we needed it most. Of course like all landlords we expect to get good quality repairs done at a value for money price for our tenants. But Mears goes much further than this for us. Mears gives livin confidence that not only do they undertake work in a safe manner in our homes but, when a crisis hits, such as recent weather patterns, Mears is on hand to resource up to respond.

"Mears offers its tenants training and advice to become more independent and it goes about its activities in a way that minimises damage to the environment."

**Wayne Harris Executive Director, livin**

"As we employ local people from within the communities we work in, we are all very much engaged with and understand the value of delivering sustainable solutions. It's not just about the regeneration of homes, it's about creating sustainable communities – developing long-lasting solutions and enabling people within communities to continue to sustain themselves once our work within an area has come to an end.

"It feels fantastic to have the opportunity to be a part of and support the transformation of people's lives and the communities we work in."

**Louise Mabrouk Customer Development Manager, Mears**

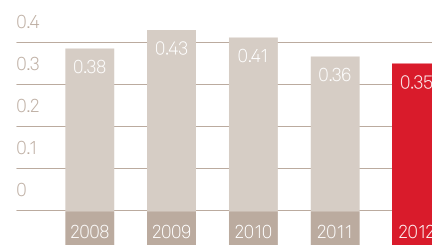
## Measuring our progress: CSR key performance indicators

### Accident Frequency Rate (AFR)

**Why we measure it**

Providing our employees with a safe working environment is paramount. In 2008, Mears introduced its own in-house training course that was accredited by the British Safety Council and has been a major factor in achieving the impressive reduction in accidents. Our AFR is calculated as the number of fatalities or reportable incidents divided by the number of hours worked multiplied by 100,000.

**AFR %** 0.35%




**Target –** Year-on-year improvement

# Your Board

**Bob Holt** 58
**Chairman**

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

**David J Miles** 47
**Chief Executive Officer**

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

**Andrew C M Smith** 40
**Finance 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 worked in professional practice prior to joining Mears.

**Peter F Dicks** 70
**Non-Executive Deputy Chairman**

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

**David L Hosein** 49
**Non-Executive Director**

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

**Davida Marston** 59
**Non-Executive Director**

Davida had a 30-year career in international banking, working in the UK, Spain and North and South America. She is a Non-Executive Director of several large companies in the financial services sector both in the UK and overseas. She also chaired the Audit and Risk Committee of Midland Heart and its predecessor Keynote Housing and was a member of the Audit Committee of Family Mosaic Housing.

**Alan Long** 50
**Executive Director**

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

**Michael G Rogers** 71
**Non-Executive Director**

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.

**Rory Macnamara** 58
**Non-Executive Director**

Rory is a Chartered Accountant with a wide range of corporate finance transaction experience. He was previously Vice Chairman and Head of Mergers and Acquisitions at Deutsche Morgan Grenfell and latterly a Managing Director at Lehman Brothers. He is currently a consultant to various companies and holds a number of Directorships including Augean PLC, Dragon Ukrainian Properties and Development plc and Essenden plc, the last of which he fulfils the role of Chairman. He is Chairman of the Group's Nomination Committee.

**Reginald B Pomphrett** 69
**Company Secretary**

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.

## Financial calendar

**Annual General Meeting**
5 June 2013

**Record date for final dividend**
14 June 2013

**Dividend warrants posted to shareholders**
2 July 2013

**Interim results announced**
13 August 2013

## Registered office

1390 Montpellier Court
Gloucester Business Park
Brockworth
Gloucester GL3 4AH
Tel: 01452 634600
www.mearsgroup.co.uk

## Company registration number

3232863

## Company secretary

**Reginald B Pomphrett**
1390 Montpellier Court
Gloucester Business Park
Brockworth
Gloucester GL3 4AH
Tel: 01452 634600

## Bankers

**Barclays Bank PLC**
Wales and South West
Business Banking
PO Box 119
Park House
Newbrick Road
Stoke Gifford
Bristol BS34 8TN
Tel: 01452 365353

**HSBC Bank plc**
West & Wales
Corporate Banking Centre
3 Rivergate
Temple Quay
Bristol BS1 6ER
Tel: 0845 583 9796

## Solicitors

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

## Auditor

**Grant Thornton UK LLP**
Registered Auditor
Chartered Accountants
Hartwell House
55–61 Victoria Street
Bristol BS1 6FT
Tel: 0117 305 7600

## Joint financial advisers and stockbrokers

**Investec Bank PLC**
2 Gresham Street
London EC2V 7QP
Tel: 020 7597 2000

**Canaccord Genuity Limited**
88 Wood Street
London EC2V 7QR
Tel: 020 7523 8000

## Registrar

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

## Investor relations

**Gable Communications**
34 Lime Street
London ECM 7AT

## Internet

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

## Registrar

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

## Investor relations

Requests for further copies of the Annual Report and Accounts, or other investor relations enquiries, should be addressed to the registered office.

## The Directors present their report together with the consolidated financial statements for the year ended 31 December 2012.

### Principal activities

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

### Business review

The Company is required to set out a fair review of the business of the Group during the reporting period. The information that fulfils this requirement can be found in the Company Overview, the Chairman's Statement, the Chief Executive Officer's Review and the Financial Review. The results of the Group can be found within the Consolidated Income Statement.

### Dividend

The final dividend in respect of 2011 of 5.35p per share was paid in July 2012. An interim dividend in respect of 2012 of 2.30p was paid to shareholders in November 2012. The Directors recommend a final dividend of 5.70p per share for payment on 2 July 2013 to shareholders on the Register of Members on 14 June 2013. This has not been included within the consolidated financial statements as no obligation existed at 31 December 2012.

### Corporate governance

A statement on the Group's corporate governance is set out on pages 34 to 39.

### Key performance indicators (KPIs)

We focus on a range of key indicators to assess our performance. Our performance indicators are both financial and non-financial and ensure that the Group targets its resources around its customers, employees, operations and finance. Collectively they form an integral part of the way that we manage the business to deliver our strategic goals. Our primary performance indicators are detailed on pages 8 to 11.

### Directors

The present membership of the Board is set out with the biographical detail on pages 28 and 29.

In line with current practice, all of the Directors will retire and, being eligible, offer themselves for re-election at the Annual General Meeting (AGM) in June 2013.

The beneficial interests of the Directors in the shares of the Company at 31 December 2012 and 31 December 2011 are detailed within the Remuneration Report on pages 45, 47 and 48.

The process governing the appointment and replacement of Directors is detailed within the Corporate Governance Report on pages 36 and 37.

### Going concern

A review of the Group's activities during the year and its outlook are set out in the Chairman's Statement and Chief Executive Officer's Review on pages 12 to 19. The financial position of the Group is described on pages 20 to 23. We principally operate in robust defensive markets, Social Housing and Care, where spend is largely non-discretionary and our contracts tend to be long-term partnerships.

The Group had net debt of £12.4m at 31 December 2012. The core debt required to satisfy the day-to-day requirements of the business is in the region of £75m. This represents significant headroom against the £120m unsecured revolving credit facility with an additional accordion mechanism allowing the facility to be increased to a maximum of £160m, maturing in July 2016. The refinancing was completed in 2011 and our ability to achieve such a refinancing at that time is a testament to the continued strong performance of the business and the strength of the longstanding relationship we share with both Barclays and HSBC.

The Directors consider that, as at the date of approving the financial statements, there is a reasonable expectation that the Group and Company have adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the financial statements.

### Amendment to Articles of Association

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

### Appointment of Directors

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

### Share capital authorisations

The 2011 AGM held in June 2012 authorised:

- » the Directors to allot shares within defined limits. The Companies Act 2006 requires Directors to seek this authority and, following changes to FSA rules and institutional guidelines, the authority was limited to one third of the issued share capital, a total of £291,389 plus an additional one third of issued share capital of £291,389 that can only be used for a rights issue or similar fund raising; and
- » the Directors to issue shares for cash on a non pre-emptive basis. This authority was limited to 5% of the issued share capital of £43,708 and is required to facilitate technical matters such as dealing with fractional entitlements or possibly a small placing.

Further details of these authorisations are available in the notes to the 2011 Notice of AGM. Shareholders are also referred to the 2012 Notice of AGM which contains similar provisions in respect of the Company's equity share capital as detailed below.

### AGM

The 2012 AGM will be held at the offices of Investec Bank PLC, 2 Gresham Street, London EC2V 7QP on 5 June 2013 at 9:30am and a formal Notice of Meeting and Form of Proxy are enclosed. The ordinary business to be conducted will include the re-appointment of all Directors.

The special business will comprise the following resolutions:

- » to authorise the Directors to allot shares within defined limits. The Companies Act 2006 requires Directors to seek this authority and, following changes to FSA rules and institutional guidelines, the authority, as in previous years, will be limited to one third of the issued share capital, a total of £306,722 plus an additional one third of issued share capital of £306,722 that can only be used for a rights issue or similar fund raising;
- » to authorise the Directors to issue shares for cash on a non pre-emptive basis. This authority is limited to 5% of the issued share capital of £46,008 and is required to facilitate technical matters such as dealing with fractional entitlements or possibly a small placing; and
- » to authorise the convening of general meetings (other than an AGM) on 14 days' notice. This results from a European Union Directive that became effective on 3 August 2010 and will override Section 307 of the Companies Act 2006 where the requirement to give 21 days' notice for certain meetings has been amended.

## Substantial shareholdings

| | Shares in issue Number | Number (m) | % |
|---|---|---|---|
| Majedie Asset Management | 8,256,971 | 8.26 | 9.0% |
| Legal & General Investment Management | 5,832,026 | 5.83 | 6.3% |
| Heronbridge Investment Management | 5,697,727 | 5.70 | 6.2% |
| Denver Investment Advisors | 5,668,006 | 5.67 | 6.2% |
| Artemis Investment Management | 4,860,000 | 4.86 | 5.3% |
| Schroder Investment Management | 4,077,304 | 4.08 | 4.4% |
| Invesco Perpetual | 4,004,041 | 4.00 | 4.4% |
| Teachers RS of Georgia | 3,566,220 | 3.57 | 3.9% |
| Four Capital Partners | 3,101,083 | 3.10 | 3.4% |
| Old Mutual Asset Managers | 2,969,393 | 2.97 | 3.2% |
| Anglian Water Group | 2,833,489 | 2.83 | 3.1% |

## Principal risks and uncertainties

Risk is an accepted part of doing business. The Group's financial risk management is based upon sound economic objectives and good corporate practice. The Board has overall responsibility for risk management and internal control within the context of achieving the Group's objectives. Our process for identifying and managing risks is set out in more detail within the Corporate Governance Statement. The key risks and mitigating factors are set out on pages 24 and 25. Details of financial risk management and exposure to price risk, credit risk and liquidity risk are given in note 21 on pages 81 to 84.

## Contracts of significance

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

## Payment policy

The Company acts purely as a holding company and as such is non-trading. Accordingly, no payment policy has been defined. However, the policy for Group trading companies is to set the terms of payment with suppliers when entering into a transaction and to ensure suppliers are aware of these terms. Group trade creditors during the year amounted to 59 days (2011: 64 days) of average supplies for the year.

## Capital structure

The Group is financed through both equity share capital and debt. Details of changes to the Company's share capital are given in note 23 to the financial statements. The Company has a single class of shares – ordinary 1p shares – with no right to any fixed income and with each share carrying the right to one vote at the general meetings of the Company. Under the Company's Articles of Association, holders of ordinary shares are entitled to participate in any dividends pro-rata to their holding. The Board may propose and pay interim dividends and recommend a final dividend for approval by the shareholders at the AGM. A final dividend may be declared by the shareholders in a32general meeting by ordinary resolution but such dividend cannot exceed the amount recommended by the Board.

## Substantial shareholdings

As at 15 March 2013 the Company has been notified of, or is aware of, the shareholders holding 3% or more of the issued share capital of the Company, as detailed in the table above.

## Disabled employees

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

## Employee information and consultation

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

## CREST

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

## Auditor

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

On behalf of the Board

**R B Pomphrett**
**Secretary**
9 April 2013

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

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

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

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

The Directors confirm that:

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

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

To the best of my knowledge:

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

By order of the Board

**A C M Smith**
**Finance Director**
9 April 2013

"To the best of my knowledge the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole."

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

## Introduction

The Board continues to be committed to maintaining the Group's operations in accordance with the highest standards of corporate governance as set out in the UK Corporate Governance Code (the 'Code') issued in June 2010 and has complied with all Code principals and relevant provisions throughout the year.

## The Board of Directors

As at 31 December 2012, the Board had nine members, comprising the Chairman, Chief Executive, Group Finance Director, Executive Director, and five independent Non-Executive Directors. P F Dicks is the Senior Independent Non-Executive Director. The Directors' biographical details are set out on pages 28 and 29. These indicate the high level and range of business experience which enables the Group to be managed effectively. Their mix of skills and business experience is a major contribution to the proper functioning of the Board and its Committees, ensuring that matters are fully debated.

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

The Board considers that each of the Non-Executive Directors who served during the year is independent in terms of judgement and character and free from any relationship that might materially interfere with the exercise of independent judgement. Notwithstanding this and for the sake of completeness, below is a summary of relationships of which shareholders should be aware:

- D L Hosein is a Director of OC&C Strategy which in the past (not in the last four years) has received fees for work carried out for the Group;
- M G Rogers became a Director of the Group in April 2007, on the acquisition of Careforce, where he continued as CEO in a purely transactional role, focused on Careforce and not involved in the Group business, until 2008 when he became a Non-Executive Director of Mears; and
- P F Dicks and R P Macnamara were Non-Executive Directors of Sportingbet PLC during the year.

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

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

## Board responsibility

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

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

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

## Leadership

The Chairman, R Holt, was formerly Chairman and Chief Executive and currently works on a part time basis reflecting the nature of his transitional role following the appointment of D J Miles as Chief Executive in November 2010. He is responsible for the leadership of the Board and ensuring its effectiveness on all aspects of its role. The Chairman sets the Board's agenda and ensures that adequate time is available for discussion of all agenda items, in particular strategic issues. The Chairman promotes a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors, in particular ensuring constructive relationships between Executive and Non-Executive Directors. The Chairman is also responsible for ensuring that the Directors receive accurate, timely and clear information.

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

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

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## Board meetings

**Board membership and Board and Committee meeting attendance:**

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

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

## Board meetings

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

During the year, six scheduled Board meetings were held.

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

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

## Evaluation of Board performance

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

The performance evaluation process included: a review of the areas of Board responsibility; the structure and composition of the Board and its Committees and the performance of the Committees; the quantity, quality and scope of information provided to the Board; the content of Board meetings and presentations to meetings; and the openness of communications between the Board members and Executive management. The Board members concluded that appropriate actions had been identified to address areas that could be improved and that, overall, the Board and its Committees continued to operate effectively.

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

Following the performance evaluation of individual Directors, the Chairman has confirmed that the Directors standing for re-election at this year's AGM continue to perform effectively and demonstrate commitment to their roles. Likewise the Senior Independent Director has given the same confirmation in respect of the Chairman. In line with current practice, all Directors will retire and, being eligible, offer themselves for re-election annually. In particular the Board is strongly of the opinion that by their actions and conduct they demonstrate their independence. It is the Board's intention to continue to annually review its performance and that of its Committees and individual Directors. A decision is taken each year on the performance evaluation process to be used.

## Senior Management Team

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

## Director development

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

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

## Board Committees

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

The Chairperson of each Committee provides a report of any meeting of that Committee at the next Board meeting. Each Committee comprises Non-Executive Directors only, as required by the UK Corporate Governance Code 2010.

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

### Audit Committee
**(see table on page 37)**

All three members of the Audit Committee are Independent Non-Executive Directors.

The Committee met four times during the year with full attendance of all members. These meetings were also attended by the Group Chief Executive Officer (CEO) and the Group Chief Financial Officer (CFO) with attendance by the Chief Risk Officer (CRO) as required. The Grant Thornton audit partner attended all of the meetings and met the Committee without management being present. There was also significant dialogue outside the formal meetings between Committee members, Executive Directors and the external auditor throughout the audit process and the preparation of the Annual Report.

The Committee has clearly defined terms of reference which outline its objectives and responsibilities relating to financial reporting, internal controls, risk management and the application of appropriate accounting policies and procedures. The Committee's terms of reference are available on the Company's website and on request from the Company Secretary.

In 2011 an external review of risk management and risk governance was undertaken to align it with best practice standards of corporate governance. The initial review resulted in the appointment of a CRO and the restructuring of the internal audit function. The work continued in 2012 with the intention that this will be rolled out to include all Group companies. The Chair of the Audit Committee was actively involved and met with the CRO and the CEO to review progress throughout the year. KPMG has been engaged as provider of independent assurance in respect of risk and internal audit and to deliver specific expertise, experience and resource as required.

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

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

The fees paid to Grant Thornton during the year in respect of non-audit services were £0.04m (2011: £0.06m). The total fees for non-audit services represented approximately 12% of the audit fees paid for the year (2011: 20%).

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

In line with best practice, it is the intention in 2013 to tender the external audit appointment.

### Nomination Committee
**(see table on page 37)**

There is a formal, rigorous and transparent procedure for the appointment of new Directors to the Board. The search for Board candidates is conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the Board, including gender. All Directors are able to allocate sufficient time to the Company to discharge their responsibilities. The Board has plans in place for orderly succession for appointments to the Board and to Senior Management. These plans aim to maintain an appropriate balance of skills and experience within the Company and on the Board and ensure progressive refreshing of the Board.

The Committee met once during the year and members of the Committee were present at the meeting. During the year, the Committee considered the membership of each sub-Committee of the Board and updated its succession.

### Remuneration Committee
**(see table on page 37)**

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

Full details of the Remuneration Committee's activities during the year are given in the Remuneration Report on pages 40 to 48.

## Board Committees continued

| Audit Committee | |
|---|---|
| Chair | D Marston |
| Membership | P F Dicks and R Macnamara |
| | The Audit Committee is comprised of financially literate members having the necessary ability and experience to understand financial statements.<br>The Committee has access to the financial expertise of the Group and its auditor and can seek further professional advice at the expense of the Group, if required. |
| Role | The Audit Committee is responsible for monitoring and reviewing:<br>» reviewing and recommending for approval by the Board the annual and interim financial statements;<br>» agreeing the scope and reviewing the results of the external audit and the setting of remuneration;<br>» reviewing the effectiveness of the Group's internal controls and risk management processes;<br>» approving the internal audit plan and monitoring the effectiveness of the internal audit function; and<br>» reviewing the 'Whistleblowing policy' by which employees and other stakeholders may raise concerns regarding potential impropriety in confidence and ensuring that these concerns are investigated appropriately. |

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

| Remuneration Committee | |
|---|---|
| Chair | P F Dicks |
| Membership | R Macnamara and M G Rogers |
| Role | The Remuneration Committee is responsible for:<br>» determining and agreeing with the Board the broad remuneration policy for:<br>  » the Chairman, the Executive Directors and Senior Management; and<br>  » the Executive Directors' remuneration and other benefits and terms of employment, including performance related bonuses and share options; and<br>» approving the service agreements of each Executive Director, including termination arrangements.<br>No Director is involved in determining his/her own remuneration. |

## The Company and its shareholders

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

There is regular dialogue with individual institutional shareholders as well as general presentations after the interim and preliminary results. Throughout the year the Group arranged a number of site visits for shareholders and other City commentators with the aim of providing them with increased exposure to our operations and management and ensuring that members of the Board develop an understanding of the views of major shareholders.

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

The Board encourages dialogue between the Directors and investors. Directors are available at each AGM and make themselves available for direct discussions with shareholders.

## Internal control and risk management

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

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

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

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

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

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

The key controls in place are:

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

> "Over the course of 2012, the principal risks, together with the risk mitigation plans, were continually monitored and enhanced. Over the course of 2013, the risk management programme will be extended across all parts of the Group, including the recent acquisition."

## Internal control and risk management continued

During 2011, the Audit Committee commissioned a detailed review of risk governance to ensure that it met the FRC guidance on best practice. The Mears Senior Management Team members, together with the assistance of external advisers, all played an integral part in this review. The key outcomes included:

- identification of the principal risks, weighting their impact on the business and likelihood of each risk occurring;
- determination of Group risk owners together with preparation of risk mitigation plans;
- appointment of a Chief Risk Officer (CRO);
- risk ratings and mitigation plans will be updated and challenged periodically. Risk owners are required to produce evidence of current mitigation and plans to increase mitigation;
- each key risk will have key 'lines of defence' to build in practical tiers of detection and protection to either avoid a risk occurring or prevent the escalation of a risk exposure;
- a formal monthly risk review is held between the CEO and CRO; and
- external validation will take place periodically.

Over the course of 2012, the principal risks, together with the risk mitigation plans, were continually monitored and enhanced. Over the course of 2013, the risk management programme will be extended across all parts of the Group, including the recent acquisition.

During 2012, a consolidated scheme of delegated authority was produced to ensure greater consistency and uniformity of corporate governance.

The principal risks and uncertainties are detailed further on pages 24 and 25.

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

## Financial reporting risk management

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

This report was approved by the Board and has been signed on its behalf by:

**P F Dicks**
**Senior Independent Non-Executive Director**
9 April 2013

We believe we have an excellent and proven management team which we wish to retain, reward and incentivise appropriately for performance.

## Dear Shareholder,

I am pleased to introduce the Mears 2012 Remuneration Report. This has been a very busy year for the Company in terms of both its operations and corporate activities. The acquisition of Morrison – referred to elsewhere in the Accounts as 'transformational' – placed significant demands on the Executives as they executed eight months of detailed negotiations at a time of record mobilisations and the full time job of 'running the business'. As the integration of Morrison progresses along with the decisions necessary to turn a loss-making business into the step changing transaction we believe it will be, the motivation of our management team is key. Therefore, we want to ensure that we have the structures in place to incentivise them appropriately for performance levels achieved. At the same time, we are confident that Mears is now in a stronger position to move forward and to build on its recent success in the future.

The Committee has determined that, for 2012, no bonuses were due to the Executive Directors as the stretching financial performance measures set at the beginning of the year were not achieved. Cognisant of the difficult market conditions within which we operate, salary levels for Executive Directors have again been frozen. This means that there have been no salary increases or bonus payments to the Executive Directors for the last three years. Due to various periods of corporate activity and the fact that the Company has been in closed periods for much of 2011 and 2012, it has not been possible to grant awards under the Long-term Incentive Plan (LTIP) in 2011 or 2012. We therefore wish to ensure that the significant efforts and achievements of the last few years are reflected in the remuneration of the Executive Team.

The remuneration policy at Mears has been a structure designed to incentivise those key Executives who are critical to execute the business strategy. Whilst strategic performance over the recent past has been strong, the difficulties with setting both appropriate short and long-term performance targets in a cyclical business combined with the inability, referred to above, to make regular share award grants has resulted in a weak link between performance and remuneration and not had the effect of being an effective incentive for Senior Management. We are also aware of the changing attitude of shareholders to Executive reward, during a period of austerity and a tough economic environment, and wish to take these factors into account with a new incentive structure given that the current LTIP arrangement expires this year.

As a result, the Committee has conducted a review of the current remuneration structure. The objective of this review has been to develop a holistic structure which strengthens the link between reward and performance – both financial and strategic performance – and act as a clear incentive to senior Executives over both the short and longer term.

The incentive structure will therefore aim to deliver an appropriate mix of cash and shares subject to forfeiture, a longer holding period and also subject to the achievement of stretching annual financial and strategic performance metrics. This approach looks to reward strong corporate performance while at the same time, aligning the interests of Executives with those of shareholders over the longer term. The focus on annual performance will also ensure that the Committee retains the flexibility to select performance metrics which drive shareholder value appropriately in a highly challenging and uncertain economic environment. The Committee believes that such a revised structure will provide the framework necessary to foster a strong performance culture, align individuals' reward with key corporate metrics, while at the same time driving shareholder value creation.

The outcome of this review and our proposals are, at the time of signing this report, subject to a consultation process with our major shareholders and key investor representative bodies. Following the outcome of this process, full details of our proposals will be provided and shareholder approval to the arrangements sought at the AGM.

We enter 2013 much as we left 2012, a struggling economy, austerity, client budget cuts and lack of clarity from Government. We believe we have an excellent and proven management team which we wish to retain, reward and incentivise appropriately for performance. I believe that the changes we are making to our remuneration structure will enable us to achieve this objective and look forward to receiving your support for these proposals in due course.

**P Dicks**
**Chairman**
Remuneration Committee

## Introduction

This report has been prepared in accordance with SI 2008/410 Schedule 8 (the 'Regulations'). The report also meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the principles and complied with the provisions of the 2010 UK Corporate Governance Code relating to Directors' remuneration. As required by the Regulations, an advisory resolution to approve the Report will be proposed at the AGM of the Company at which the financial statements will be approved.

The auditor is required to report on the 'auditable' part of this Report and to state whether, in its opinion, that part of the Report has been properly prepared in accordance with the Companies Act 2006. The report is therefore divided into separate sections for audited and unaudited information.

## Part 2 of the Regulations – unaudited information

### Remuneration Committee

The Directors who were members of the Remuneration Committee (the 'Committee') during the year are shown on page 37.

In 2012, the Committee continued to engage PwC and received wholly independent advice on Executive compensation.

The Committee is formally constituted with written terms of reference and its main responsibilities are detailed in the Corporate Governance Statement on page 37.

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

The Committee met twice during 2012 and discussed, amongst others, the issues set out in the table below.

### Annual overview

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

- improve the level of openness and transparency in remuneration reporting through a detailed annual Remuneration Report;
- reduce the Chairman's salary following the separation of roles in 2010;
- operate a structured bonus arrangement with clear financial performance targets for each year;
- undertake a regular review of the remuneration policies for Executive Directors and other Senior Executives within the Group to ensure that they remain appropriate to retain and motivate such individuals;
- take into account the changes to principles proposed by the Walker Review and other pronouncements by regulatory bodies and institutional shareholders and their representative bodies;
- consider pay policies within the Group as a whole when determining Executive Directors' remuneration packages;
- encourage Executive Directors and Senior Executives to build up a meaningful shareholding in the Company to more closely align the interests of shareholders and Executives; and
- to be kept fully aware and informed on developments and best practice in the field of remuneration and corporate governance from external advisers, institutional shareholders and their representative bodies.

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

The Committee has adopted the remuneration principles in the table on page 42 in supporting its primary objective of ensuring that the Group has in place a remuneration structure that is able to incentivise and retain highly skilled and motivated individuals who are the cornerstone of the continued success of the Group.

### Remuneration Committee

| Meeting | Key issues discussed | Attendees |
|---|---|---|
| April | » A review of Executive Directors' and Senior Management's base salaries and pension provision | All Committee members |
| | » Consideration of bonus payments for Executive Directors | |
| | » Approval of the 2011 Directors' Remuneration Report | |
| | » Structure and performance targets of LTIP | |
| | » Deferral of 2011 LTIP awards pending outcome of review in conjunction with advisers | |
| December | » Review of Executive Directors' incentive structure for 2013 | All Committee members |
| | » Deferral of 2012 LTIP awards | |
| | » Review of pension contributions made in respect of Executive Directors | |

## Part 2 of the Regulations – unaudited information continued

### Remuneration policy and philosophy

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

### Incentive arrangements review

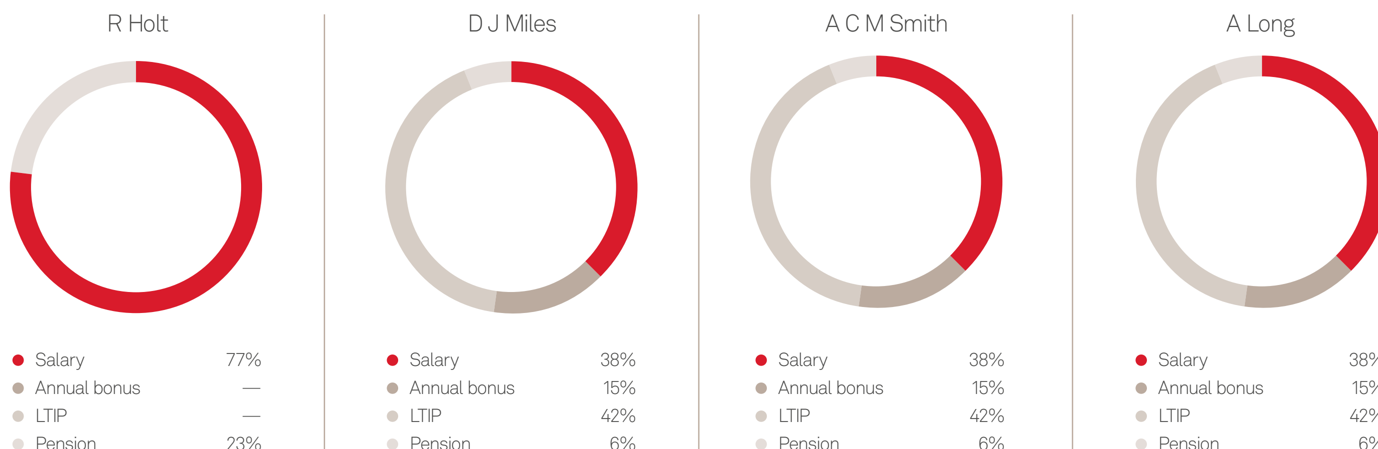
At the end of 2012, the Committee determined that it would be an appropriate time to review the incentive arrangements to ensure that they are aligned with and supportive of the Group's business strategy following the acquisition of Morrison, and that they are effective in providing exceptional levels of payment if outstanding performance has been achieved. The Committee is also cognisant of changes in market practice in the area of Executive remuneration. The key principles underlying this review are:

- » there should be a holistic structure which strengthens the link between reward and performance over the short and longer term;
- » the performance targets used in incentive arrangements should be directly linked to the Group's strategic and business targets;
- » the incentive arrangements should provide greater alignment with shareholder interests and encourage a long-term view to be taken by participants;
- » if a minimum level of performance is not achieved, there should be a mechanism in place to claw back awards or for awards to be forfeited; and
- » the incentive arrangements should promote retention of the Executive Directors and other key Executives over an appropriate period to execute the Group's business strategy.

As explained in the Chairman's letter, at the time of finalising this report, the outcome of this review and proposals are subject to a consultation process with our major shareholders and key investor representative bodies. Following the outcome of this process, full details of our proposals will be provided and shareholder approval to the arrangements sought at the AGM.

Given the current review of the incentive arrangements, the charts below demonstrate the balance between fixed and variable pay for target and maximum performance for Executive Directors' remuneration in 2012 in line with the relevant policy. It should be noted that no awards were granted under the LTIP in respect of 2011 or 2012. Further, R Holt does not participate in the annual bonus plan and is not granted awards under the LTIP:

Target remuneration as a percentage of total remuneration for each Executive Director



## Part 2 of the Regulations – unaudited information continued

### Remuneration policy and philosophy continued

#### Salary

The purpose of the base salary is to:

- help recruit and retain key individuals;
- reflect the individual's experience, role and contribution within the Group; and
- ensure fair reward for 'doing the job'.

The Committee reviews base salaries annually in April in order to ensure that Executive Directors remain competitively aligned with external market practices.

The Committee will retain the discretion to increase an individual's salary where there is a significant difference between current levels and a market competitive rate. However, in determining whether to increase levels the Committee will take the following into consideration:

- the performance of the individual Executive Director;
- the individual Executive Director's experience and responsibilities;
- the impact on fixed costs of any increase; and
- pay and conditions throughout the Group.

As communicated in previous years' Remuneration Reports, the Committee is committed to reviewing the salary level for the Chairman, which historically reflected his combined role of Chairman and Chief Executive. Since the separation of roles in late 2010, the Committee has progressively reduced his base salary to levels which are aligned with salaries received by Executive Chairmen at similar size companies. In 2012 his base salary was further reduced from £350,000 to £250,000. In respect of 2013, the Chairman's salary will remain at £250,000. This is to reflect the fact that, leading up to and since the completion of the Morrison acquisition and in the year to come, the duties performed by the Chairman and his ongoing time commitment to Mears have increased. The Chairman's expertise and strategic input are vital in combining the two businesses and the success of this acquisition. Maintaining his salary level at £250,000 for 2013 reflects this. However the fact that the salary level is being maintained in 2013 is not indicative of future levels and the Committee will continue to review at regular intervals the role and responsibilities of the Chairman going forward in accordance with the implementation of the succession planning strategy and to ensure that it remains appropriate based on his ongoing role and responsibilities.

When setting the salary levels for the Executive Directors, in addition to the factors summarised above, salary levels paid by a number of comparator companies of a similar size to Mears are taken into account.

The table below shows the Executive Directors' salaries for 2012. As indicated above, salaries will be reviewed in (and changes, if any, will be effective from) April 2013:

| | **Base salary 2013** | Base salary 2012 |
|---|---|---|
| R Holt | **£250,000** | £250,000 |
| D J Miles | **£330,000** | £330,000 |
| A C M Smith | **£220,000** | £220,000 |
| A Long | **£180,000** | £180,000 |

#### External appointments

R Holt is Chairman and Chief Executive of Green Compliance PLC and Non-Executive Chairman of Inspired Energy PLC and receives fees totalling £61,000.

#### Annual bonus

For the year ended 31 December 2012 the Group offered Executive Directors and Senior Management the opportunity to earn performance related bonuses. Maximum bonus levels and the proportion payable for on-target performance are considered in the light of market bonus levels for similar roles among our competitors and in the quoted support services sector. This bonus structure is subject to the review mentioned above.

In respect of 2012, the maximum bonus potential for the Executive Directors was limited to 75% of salary. It should be noted that bonus payments are not pensionable. As disclosed last year, with effect from 2012, the Committee's intention is that a significant portion of any bonus payments due to Executive Directors will be paid in shares rather than cash.

In 2012, the Committee set clear objectives for each individual Executive Director relating to Group KPIs, plus individual (where relevant) divisional and strategic targets, taking into account where an individual has particular influence and responsibility. The performance against the Group KPIs is measured using a balanced scorecard approach which is applied to each of the Executive Directors.

#### Annual bonus

| Measure | Proportion | Objective | | | | |
|---|---|---|---|---|---|---|
| Financial performance | 2/3 | The Group's financial performance is measured against annual budgets that drive corporate performance. | Profit before tax and amortisation (PBTA) | Threshold | Budget | Maximum |
| | | | Achievement | <100% | 100% | 110% |
| | | | Payment – % of salary | 0% | 26.67% | 50% |
| Personal objectives | 1/3 | Performance is measured annually against agreed personal objectives that will support the achievement of the Group's business goals. | Typical KPIs include: | Below target | Target | Maximum |
| | | | Business development<br>Bid wins ratios<br>Working capital control<br>Service ratings<br>Margins<br>Complaint ratios<br>Jobs completed on time ratios<br>People development<br>HSE targets<br>Revenue growth | Aggregate payout is 0% | Aggregate payout is 13.33% | Aggregate payout is 25% |
| **Total bonus (as % of base salary)** | | | | **—** | **40%** | **75%** |

## Part 2 of the Regulations – unaudited information continued

### Remuneration policy and philosophy continued

#### Annual bonus continued

Such targets included:

- delivery and mobilisation of new contracts;
- delivery of acquisition strategy;
- shaping and development of the Care business;
- succession planning; and
- financial performance.

For 2012, annual bonuses were based on a combination of performance measures as stated in the table below.

The proportion of the bonus awarded that is based on an individual's personal objectives is conditional upon the achievement of the budget performance target, at which point this part of the award will be subject to the performance targets indicated in the table on page 43.

As described above, the structure of the annual bonus plan is currently being reviewed. To the extent that any changes to the 2012 structure are proposed as a consequence of this review, shareholders will be consulted on the proposals before they are implemented.

#### Benefits

The Executive Directors receive additional benefits including a company provided car or an allowance in lieu, life assurance and private medical insurance. Benefits-in-kind are not pensionable.

#### Pensions

All Executive Directors receive a contribution into their respective defined contribution plans which are subject to periodic review to ensure that they remain in line with rates applicable in the market. Only the base salary is pensionable. With the exclusion of R Holt, the Committee reviewed the pension contribution rates paid in respect of Executive Directors at its meeting in December 2011 and agreed to increase these rates to 15% per annum, which is in line with the current market. This increase became effective from January 2012. No increases are proposed for 2013. The pension contribution rate in respect of R Holt remains 30% per annum.

The contribution rates, together with the amounts paid into the defined contribution plans, are set out in the audited section of this report on page 47.

#### Share awards

Long-term Incentive Plan (LTIP)

The Committee's policy, which is subject to review, has been to provide market competitive annual share grants to Executive Directors and certain members of the Senior Management Team.

The two conditions are measured independently. Awards will be released on the third anniversary of the date of grant subject to the achievement of the relevant performance conditions over the same period.

Pending a review of the structure and performance targets of the LTIP, the Committee did not grant LTIP awards to the Executive Directors during the 2011 financial year. Further, no LTIP awards were granted to the Executive Directors during the 2012 financial year, which means that no LTIP awards have been granted since 2010. The Committee acknowledges that, in line with its remuneration policy and philosophy, it is vital that incentive arrangements are in place to drive exceptional performance and to deliver a significant proportion of the Executive Directors' total remuneration through performance related pay and equity, where justified by performance levels. Therefore, the structure of the LTIP is being considered as part of the incentive arrangements review referred to elsewhere in this report. To the extent that any changes to the current LTIP structure are proposed as a consequence of this review, shareholders will be consulted on the proposals before they are implemented.

The following table sets out the level of vesting based on performance to date for all outstanding LTIP awards. The performance targets and vesting mechanism are detailed on page 47. The performance period of the LTIP awards granted in October 2009 ended in October 2012. The Group reported an average annual EPS growth rate of 11.08% which resulted in 18.64% of the options linked to EPS performance vesting. None of the options linked to TSR performance vested.

#### The main terms and conditions of the LTIP

| Feature | Terms and conditions |
|---|---|
| Maximum individual limit | 200% of salary p.a.<br>Awards made annually in the form of 1p options. |
| Performance conditions | 75% of the award vests based on the growth in Group EPS performance over a three-year performance period. EPS targets are set by reference to consensus analyst forecasts with maximum payout at a significant stretch to this level. Awards are underpinned by a comparative TSR measure whereby the Group's growth in TSR must at least exceed the return of an appropriate comparator group.<br>25% of the award is subject to the Group's TSR growth against the return of an appropriate comparator group over a three-year performance period. |

#### The level of vesting based on performance to date for all outstanding LTIP awards

| | | Percentage of award vesting | | |
|---|---|---|---|---|
| Year of grant | Performance period | TSR | EPS | Total vesting |
| 2009 | October 2009–October 2012* | — | 18.6% | 14.0% |
| 2010 | August 2010–August 2013** | — | 21.0% | 15.8% |

* Actual.

** Projected given performance to date.

No LTIP awards were granted in 2011 or 2012.

## Part 2 of the Regulations – unaudited information continued

### Share options

Although the policy on equity incentives is through the provision of the LTIP Awards, Executive Directors and members of the Senior Management Team hold share options in the Company which were granted prior to adoption of the LTIP.

The tables on pages 47 and 48 set out the number of share awards held by the Executive Directors. There were no share option awards in 2012.

### All-employee share plans

The Group encourages share ownership by employees and, accordingly, it operates an all-employee share plan.

Under the terms of the Sharesave Plan all UK employees can save up to £250 per month and receive three or five-year options to acquire the Company's shares priced at a discount of up to 20%. In December 2011 invitations were issued to all eligible employees (other than Directors) at an option price of 178p which resulted in applications for 1,357,977 options from 664 employees, all of which were accepted in full.

### Dilution

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

### Shareholder consultation

During the 2012 financial year, the Company did not consult with shareholders on Executive remuneration, although it did provide clarification on the remuneration policy and Committee's intentions as regards the granting of LTIP awards to various investor bodies. The Company received support from 83% of shareholders who voted in respect of its 2011 Remuneration Report.

### Other remuneration matters

#### Executive Directors' contracts

Details of the service contracts of the Executive Directors of the Company are as follows:

| Name | Notice period | Contract date |
|---|---|---|
| R Holt | 6 months | June 2008 |
| D J Miles | 12 months | June 2008 |
| A C M Smith | 12 months | June 2008 |
| A Long | 12 months | August 2009 |

All Executive Directors' contracts are rolling and, therefore, will continue unless terminated by written notice. In the event of the termination of an Executive's contract, salary and benefits will be payable during the notice period (there will, however, be no automatic entitlement to bonus payments or share incentive grants during the period of notice other than where normal good leaver provisions apply). If there has been a performance failure, the Committee will ensure that there have been no unjustified payments. There are no special provisions in the contracts of employment extending notice periods on the liquidation of the Company or cessation of employment. The maximum notice period on a change of control is twelve months.

Executive Directors have an obligation to inform the Board, specifically the Remuneration Committee, of any Non-Executive positions held or being contemplated and of the associated remuneration package. The Remuneration Committee will consider the merits of each case and carefully consider the work and time commitment required to fulfil the Non-Executive duties and the potential benefit to the Group and then determine whether the remuneration should be retained by the Executive or passed over to the Group.

#### Non-Executive Directors' fee level

The remuneration of the Non-Executive Directors is determined by the Board and is within the limits set by the Articles of Association. Assistance is also available from the Group's remuneration advisers.

Each Non-Executive Director was paid an annualised fee of £42,000 for 2011 and £45,000 for 2012. These fees are subject to review in 2013. No additional fees are paid for Committee membership or other normal duties and Non-Executive Directors do not participate in any incentive, pension or bonus arrangements.

Details of the current Non-Executive Directors' appointment dates are:

| Name | Effective date of letter of appointment or last renewal |
|---|---|
| D L Hosein | June 2008 |
| M G Rogers | June 2008 |
| P F Dicks | June 2008 |
| D Marston | June 2010 |
| R Macnamara | June 2010 |

Non-Executive Directors do not have service contracts. Letters of appointment run for a rolling six-month period.

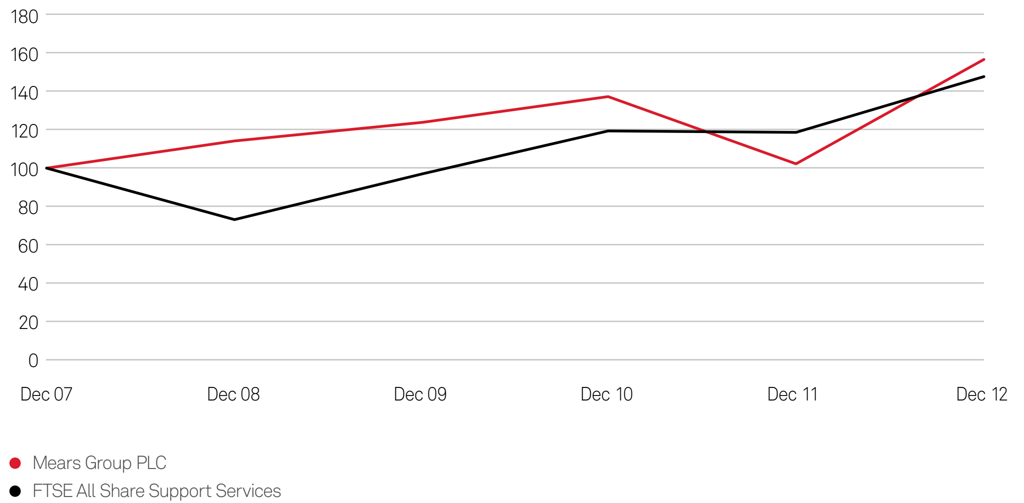
### Directors' interests

The beneficial interests of the Directors in the shares of the Company at 31 December 2012 and 31 December 2011 are detailed below:

| | Ordinary shares | |
|---|---|---|
| | **31 December 2012 Number** | 31 December 2011 Number |
| R Holt | **—** | 500,000 |
| D J Miles | **110,000** | 110,000 |
| A C M Smith | **105,000** | 50,000 |
| A Long | **4,108** | 4,108 |
| M G Rogers | **72,420** | 102,420 |
| D L Hosein | **—** | — |
| P F Dicks | **23,298** | 23,298 |
| D Marston | **15,342** | 15,324 |
| R Macnamara | **—** | — |

## Five-year TSR performance graph

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




## Part 3 of the Regulations – audited information

The remuneration of each Director, excluding long-term, share-based incentive awards and pensions, during the year ended 31 December 2012 compared with 2011 is set out in the table below:

| Directors' remuneration | Fees/ basic salary £'000 | Bonus £'000 | Benefits-in-kind £'000 | **2012 Total £'000** | 2011 Total £'000 |
|---|---|---|---|---|---|
| Executive | | | | | |
| R Holt | 250 | — | 20 | **270** | 365 |
| D J Miles | 330 | — | 29 | **359** | 339 |
| A C M Smith | 220 | — | 6 | **226** | 226 |
| A Long | 180 | — | 11 | **191** | 190 |
| | 980 | — | 66 | **1,046** | 1,120 |
| Non-Executive | | | | | |
| M A Macario* | — | — | — | **—** | 21 |
| D L Hosein | 45 | — | — | **45** | 42 |
| M G Rogers | 45 | — | — | **45** | 42 |
| P F Dicks | 45 | — | — | **45** | 42 |
| D Marston | 45 | — | — | **45** | 42 |
| R Macnamara | 45 | — | — | **45** | 42 |
| | 225 | — | — | **225** | 231 |
| Total remuneration | 1,205 | — | 66 | **1,271** | 1,351 |

* M A Macario did not seek re-election at the AGM on 8 June 2011.

## Part 3 of the Regulations – audited information continued

### Executive Directors' pensions (defined contribution)

| | 2012 £'000 | 2012 % of base salary | 2011 £'000 | 2011 % of base salary |
|---|---|---|---|---|
| R Holt | **75** | **30** | 105 | 30 |
| D J Miles | **50** | **15** | 45 | 14 |
| A C M Smith | **33** | **15** | 22 | 10 |
| A Long | **27** | **15** | 18 | 10 |
| | **185** | | 190 | |

### Mears Group PLC Long-term Incentive Plan (LTIP)

The LTIP was approved by shareholders on 1 October 2008. Awards under the LTIP are set out in the table below:

| Date of grant | LTIP Awards to 1 January 2012 | Lapsed | Exercised | LTIP Awards held at 31 December 2012 | Date of release |
|---|---|---|---|---|---|
| **D J Miles** | | | | | |
| 13 October 2008[1] | 26,550 | — | — | **26,550** | October 2011 |
| 28 October 2009[2] | 100,000 | (86,020) | — | **13,980** | October 2012 |
| 24 August 2010[3] | 175,000 | — | — | **175,000** | August 2013 |
| **A C M Smith** | | | | | |
| 13 October 2008[1] | 26,550 | — | (26,550) | **—** | October 2011 |
| 28 October 2009[2] | 100,000 | (86,020) | — | **13,980** | October 2012 |
| 24 August 2010[3] | 130,000 | — | — | **130,000** | August 2013 |
| **A Long** | | | | | |
| 13 October 2008[1] | 26,550 | — | — | **26,550** | October 2011 |
| 28 October 2009[2] | 100,000 | (86,020) | — | **13,980** | October 2012 |
| 24 August 2010[3] | 100,000 | — | — | **100,000** | August 2013 |

1 The performance applicable to 2008 awards is subject to EPS growth (50% of the award) of 10%, 12.5% and 17.5% p.a. for 10%, 30% and 100% vesting and TSR performance against the FTSE All Share Support Services Sector (50% of the award) where 30% vests for performance equal to the Index and full vesting occurs for outperforming the Index by 10%.

2 The performance applicable to 2009 awards is subject to EPS growth (75% of the award) of 10%, 12.5% and 15% p.a. for 10%, 30% and 100% vesting and TSR performance against the FTSE All Share Support Services Sector (25% of the award) where 30% vests for performance equal to the Index and full vesting occurs for outperforming the Index by 10%.

3 The performance applicable to 2010 awards is subject to EPS growth (75% of the award) of 8%, 12.5% and 15% p.a. for 10%, 30% and 100% vesting and TSR performance against the FTSE All Share Support Services Sector (25% of the award) where 30% vests for performance equal to the Index and full vesting occurs for outperforming the Index by 10%.

LTIP Awards are in the form of 1p options. If the relevant EPS and TSR performance conditions attaching to the awards are satisfied then the Director has seven years in which to exercise the award.

## Part 3 of the Regulations – audited information continued

**Details of Directors' interests in shares held under option**

Executive Directors hold the following options granted under the Mears Group Share Option Scheme or Special Incentive Plan:

| Date of grant | At 1 January 2012 | Lapsed | Exercised | **At 31 December 2012** | Exercise price p | Exercisable dates |
|---|---|---|---|---|---|---|
| **R Holt** | | | | | | |
| 28 September 2009[1] | 2,500,000 | — | (1,500,000) | **1,000,000** | 1 | 2010–2019 |
| **D J Miles** | | | | | | |
| 1 April 2004[3] | 30,453 | — | — | **30,453** | 1 | 2007–2014 |
| 8 April 2005[3] | 7,220 | — | — | **7,220** | 1 | 2008–2015 |
| 21 April 2006 | 10,000 | — | — | **10,000** | 300 | 2009–2016 |
| 21 April 2006[3] | 6,087 | — | — | **6,087** | 1 | 2009–2016 |
| 28 September 2007[3] | 50,045 | — | — | **50,045** | 1 | 2010–2017 |
| 20 March 2008[3] | 151,149 | — | — | **151,149** | 1 | 2011–2018 |
| **A C M Smith** | | | | | | |
| 10 April 2003[2] | 50,000 | — | (50,000) | **—** | 77 | 2006–2013 |
| 1 April 2004[2,3] | 24,363 | — | (24,363) | **—** | 1 | 2007–2014 |
| 8 April 2005[2,3] | 7,220 | — | (7,220) | **—** | 1 | 2008–2015 |
| 21 April 2006 | 10,000 | — | — | **10,000** | 300 | 2009–2016 |
| 21 April 2006[3] | 6,087 | — | — | **6,087** | 1 | 2009–2016 |
| 28 September 2007[2,3] | 50,045 | — | (50,045) | **—** | 1 | 2010–2017 |
| 20 March 2008[2,3] | 100,766 | — | (100,766) | **—** | 1 | 2011–2018 |
| **A Long** | | | | | | |
| 21 April 2006 | 10,000 | — | — | **10,000** | 300 | 2009–2016 |
| 21 April 2006[3] | 6,087 | — | — | **6,087** | 1 | 2009–2016 |
| 28 September 2007[3] | 20,018 | — | — | **20,018** | 1 | 2010–2017 |
| 20 March 2008[3] | 75,575 | — | — | **75,575** | 1 | 2011–2018 |

1 On 22 March 2012 R Holt, Chairman of Mears, exercised share options (granted in 2009 with a condition of continued employment and a condition relating to EPS growth over a three-year period) over 1,500,000 ordinary shares in the Company. The resulting shares were sold on the same day at an average price of 250p per share.

2 On 2 April 2012, A C M Smith, Finance Director of Mears, exercised share options (granted in 2003, 2004, 2005, 2007 and 2008 with a condition of continued employment) over 258,944 ordinary shares. 203,944 of the resulting shares were sold on 3 April 2012 and 10 April 2012 at an average price of 259.26p.

3 For those options with an exercise price of 1p, these options which were previously market-priced options but were replaced with a lower number of 1p options with the same expected value and terms and conditions. These 1p options can only be exercised if the share price is greater than the original exercise price of the market-priced options.

Options are exercisable at the prices indicated which are 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 and are forfeited if the Director leaves Mears Group PLC before the option vests.

The market price of the Company's shares at 31 December 2012 was 328p and the range during 2012 was 216p to 335p.

The agreements covering Directors' options and LTIP Awards are available for inspection at the Group's offices. The Company's Register of Directors' Interests (which is also open to inspection) contains full details of the Directors' shareholdings and options to subscribe.

This report was approved by the Board and has been signed on its behalf by:

**P F Dicks**
**Chairman of the Remuneration Committee**
9 April 2013

## We have audited the financial statements of Mears Group PLC for the year ended 31 December 2012 which comprise the Group principal accounting policies, Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated Balance Sheet, Consolidated Cash Flow Statement, Consolidated Statement of Changes in Equity, related Group notes, Company principal accounting policies, Parent Company Balance Sheet and related Company notes.

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

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

### Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 33, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (United Kingdom and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

### Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2012 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Corporate Governance Statement set out on pages 34 to 39 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

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

We have nothing to report in respect of the following:

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

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

Under the Listing Rules, we are required to review:

- the Directors' statement, set out on page 31, in relation to going concern;
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to the shareholders by the Board on Directors' remuneration.

**Simon J Lowe**
**Senior Statutory Auditor**
**for and on behalf of Grant Thornton UK LLP**
**Statutory Auditor, Chartered Accountants**
**Bristol**
9 April 2013

## Basis of preparation

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

The accounting policies remain unchanged from the previous year except for the adoption of amendments to IFRS 7 'Financial Instruments: Disclosures'.

IFRS 7 'Financial Instruments: Disclosures' was effective from 1 January 2012 and has had no material impact on the Group.

The Directors consider that as at the date of approving the financial statements, there is a reasonable expectation that the Group and Company have adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the financial statements. The Directors have discussed the principal risks and uncertainties of the business in the Risk Management section on pages 24 and 25.

## Basis of consolidation

The Consolidated Balance Sheet includes the assets and liabilities of the Company and its subsidiaries and is made up to 31 December 2012. Entities over which the Group has the ability to exercise control over financial and operating policies are accounted for as subsidiaries. Control is obtained and exercised through voting rights so as to obtain benefits from 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.

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

## Business combinations

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

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

Costs relating to acquisitions in the year have been expensed.

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

## Property, plant and equipment

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

## Property, plant and equipment continued

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

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

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

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

## Intangible assets

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

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

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

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

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

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

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

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

## Intangible assets continued

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

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

## Goodwill

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

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

## Impairment

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

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

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

## Inventories

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

## Work in progress

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

## Amounts recoverable on contracts

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

## Accounting for taxes

Income tax comprises current and deferred taxation.

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

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

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

## Accounting for taxes continued

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

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

## Revenue

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

### Social Housing

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

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

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

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

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

#### Schedule of Rates (SOR) contracts

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

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

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

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

## Revenue continued

### Social Housing continued

#### Open book contracts

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

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

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

#### Lump sum contracts

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

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

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

### Care

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

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

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

### Construction contracts

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

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

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

## Revenue continued

**Construction contracts** continued

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

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

## Segment reporting

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

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

## Exceptional costs

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

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

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

## Employee benefits

**Retirement benefit obligations**

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

**i) Defined contribution pensions**

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

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

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

**ii) Defined benefit pensions**

The Group contributes to 30 principal defined benefit schemes which require contributions to be made to separately administered funds.

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 Consolidated Statement of Comprehensive Income. The net surplus or deficit is presented with other net assets on the Consolidated 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.

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

In accordance with IFRIC 14, the asset that is recognised is restricted to the amount by which the IAS 19 service cost is expected, over the lifetime of the scheme, to exceed funding contributions payable in respect of accruing benefits.

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

## Employee benefits continued

### Share-based employee remuneration

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

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

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

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

Modifications to share-based payment arrangements are accounted for in accordance with IFRS 2. The modifications made by the Group in 2009 did not increase the fair value of the equity instruments granted and, therefore, there was no change to the share-based payment charge as a result.

### Leases

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

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

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

The Group does not act as a lessor.

## Financial instruments

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

### Financial assets

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

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

### Loans and receivables

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

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

## Financial instruments continued

### Loans and receivables continued

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

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

### Financial liabilities

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

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

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

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

Trade payables on normal terms are not interest bearing and are stated at their fair value.

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

## Derivative financial instruments

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

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

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

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

## Hedge accounting for interest rate swaps

Where an interest rate swap is designated as a hedge of the variability in cash flows of an existing or highly probable forecast loan interest payment, the effective part of any valuation gain or loss on the swap instrument is recognised in other comprehensive income in the hedging reserve. The cumulative gain or loss is removed from equity and recognised in the Income Statement at the same time as the hedged transaction. The ineffective part of any gain or loss is recognised in the Income Statement immediately.

When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer probable, the cumulative unrealised gain or loss recognised in equity is recognised in the Income Statement immediately.

## Nature and purpose of each reserve in equity

Share capital is determined using the nominal value of shares that have been issued.

Share premium represents the difference between the nominal value of shares issued and the total consideration received.

Equity-settled shared-based employee remuneration is credited to the share-based payment reserve until the related share options are exercised. Upon exercise the share-based payment reserve is transferred to retained earnings.

The hedging reserve represents the effective part of any gain or loss on a cash flow hedge which has not been removed from equity and recognised in the Income Statement.

The merger reserve relates to the difference between the nominal value and total consideration in respect of the acquisition of Careforce Group plc, Supporta plc and Morrison Facilities Services Limited where the Company was entitled to the merger relief offered by the Companies Act.

## Dividends

Dividend distributions payable to equity shareholders are included in 'Current financial liabilities' when the dividends are approved in a general meeting prior to the balance sheet date.

## Use of judgements and estimates

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

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

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

### Critical judgements in applying the Group's accounting policies

#### Revenue recognition

Revenue is recognised based on the stage of completion of job or contract activity. As described in the Revenue section on pages 53 and 55, certain types of Social Housing pricing mechanisms and Care require minimal judgement; however, Social Housing lump sum contracts and construction contracts do require judgements and estimates to be made to determine the stage of completion and the expected outcome for the individual contract.

#### Capitalisation of development expenditure

Development expenditure is capitalised to the extent that it meets the criteria described in the Intangible assets section on pages 51 and 52. Careful judgement is exercised by management when deciding whether the recognition requirements for development costs have been met. This is necessary as the economic success of any development is uncertain and may be subject to future technical problems at the time of recognition. Judgements are based on the information available at each balance sheet date.

### Key sources of estimation uncertainty

#### Impairment of goodwill

Determining whether goodwill is impaired requires an estimate of the value in use of the CGUs to which goodwill has been allocated. The value-in-use calculation involves an estimate of the future cash flows of the CGUs and also the selection of appropriate discount rates to calculate present values. Future cash flows are estimated using the current one-year budget forecast, extrapolated for a future growth rate. The estimated growth rates are based on past experience and knowledge of the individual sector's markets. Changes in the estimated growth rate could result in variations to the carrying value of goodwill. The Directors consider that the estimates and judgements involved in determining the value in use of the Care CGU goodwill are the most significant and have therefore utilised the services of an external consultant to undertake this impairment review. The estimated cash flows and future growth rates are based on past experience and knowledge of the sector. The value in use is most sensitive to changes in the terminal growth rate, the explicit growth rate and the discount rate. The sensitivity to changes in these estimations is detailed in note 11.

#### Defined benefit liabilities

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

- expected return on plan assets;
- inflation rates;
- mortality;
- discount rate; and
- salary and pension increases.

## Use of judgements and estimates continued

### Key sources of estimation uncertainty continued

**Defined benefit liabilities** continued

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

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

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

## New standards and interpretations not yet applied

Amendments to IAS 1 'Presentation of Financial Statements' – presentation of items of Other Comprehensive Income (effective 1 July 2012). The Group will apply this revised standard for the Group's 31 December 2013 financial statements, The revised standard requires the grouping of items included in Other Comprehensive Income on the basis of whether they are potentially reclassifiable to profit of loss.

IAS 19 (revised) 'Employee Benefits' (effective 1 January 2013). The Group will apply this revised standard for the Group's 31 December 2013 financial statements. The revised standard combines interest on obligation and expected return on plan assets and requires the disclosure of the net interest on liability; it also requires the separate disclosure of expenses for running the plan. As a result asset returns will be based on the discount rate instead of the expected rate of return on assets. This is expected to result in a lower expected return in the Income Statement and a higher gain in the Statement of Comprehensive Income. The revised standard will require the restatement of the prior year comparative. The effect on the Income Statement for 2012 is expected to be an increase in operating costs of £0.3m and a decrease in finance income of £2.3m. There would be a corresponding decrease in the actuarial loss recognised in the Statement of Consolidated Income of £2.6m. There would be no change to net assets.

IAS 27 (revised) 'Separate Financial Statements' (adopted by the EU from 1 January 2014). The Group will apply this revised standard for the Group's 31 December 2014 financial statements.

IAS 28 (revised) 'Investments in Associates and Joint Ventures' (adopted by the EU from 1 January 2014). The Group will apply this revised standard for the Group's 31 December 2014 financial statements.

Amendments to IAS 32 'Financial Instruments: Presentation' – offsetting financial assets and financial liabilities (effective 1 January 2013) and Amendments to IFRS 7 'Financial Instruments: Disclosures' – offsetting financial assets and financial liabilities (effective 1 January 2014). The revised standards require the disclosure of information which will allow the users of accounts to evaluate the effect or potential effect of netting off arrangements associated with financial assets or financial liabilities. The Group will apply the revisions to IAS 32 for the Group's 31 December 2013 financial statements and the revisions to IFRS 7 for the Group's 31 December 2014 financial statements.

IFRS 9 'Financial Instruments' (effective 1 January 2015) specifies how an entity should classify and measure financial assets, including some hybrid contracts. The Group will apply this standard for the Group's 31 December 2015 financial statements.

IFRS 10 'Consolidated Financial Statements' (adopted by the EU from 1 January 2014) establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. The Group will apply this standard for the Group's 31 December 2014 financial statements.

IFRS 11 'Joint Arrangements' (adopted by the EU from 1 January 2014) establishes principles for financial reporting by parties to a joint arrangement. The Group will apply this standard for the Group's 31 December 2014 financial statements.

IFRS 12 'Disclosures of Interests in Other Entities' (adopted by the EU from 1 January 2014) requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The Group will apply this standard for the Group's 31 December 2014 financial statements.

IFRS 13 'Fair Value Measurement' (effective 1 January 2013) explains how to measure fair value for financial reporting. The Group will apply this standard for the Group's 31 December 2013 financial statements.

With the exception of the amendments to IAS 19 where the anticipated effect is disclosed above, the Directors do not expect that the adoption of these standards and amendments will have a material impact on the financial statements of the Group in future periods.

| | Note | 2012 Existing £'000 | 2012 Acquired £'000 | 2012 Total £'000 | 2011 Total £'000 |
|---|---|---|---|---|---|
| Sales revenue | 1 | **634,484** | **45,041** | **679,525** | 588,971 |
| Cost of sales | | **(460,761)** | **(34,862)** | **(495,623)** | (414,207) |
| Gross profit | | **173,723** | **10,179** | **183,902** | 174,764 |
| Other administrative expenses | | **(140,016)** | **(12,445)** | **(152,461)** | (141,156) |
| Exceptional costs | 7 | **—** | **(2,877)** | **(2,877)** | (3,094) |
| Amortisation of acquisition intangibles | 12 | **(7,408)** | **(553)** | **(7,961)** | (7,783) |
| Total administrative costs | | **(147,424)** | **(15,875)** | **(163,299)** | (152,033) |
| Operating profit before exceptional costs and amortisation of acquisition intangibles | | **33,707** | **(2,266)** | **31,441** | 33,608 |
| Operating profit | | **26,299** | **(5,696)** | **20,603** | 22,731 |
| Finance income | 4 | **2,648** | **479** | **3,127** | 484 |
| Finance costs | 4 | **(2,802)** | **(115)** | **(2,917)** | (2,633) |
| Profit for the year before tax, exceptional costs and the amortisation of acquisition intangibles | | **33,553** | **(1,902)** | **31,651** | 31,459 |
| Profit for the year before tax | 2 | **26,145** | **(5,332)** | **20,813** | 20,582 |
| Tax expense | 8 | **(2,996)** | **1,479** | **(1,517)** | (3,668) |
| Profit for the year | | **23,149** | **(3,853)** | **19,296** | 16,914 |
| **Attributable to:** | | | | | |
| Equity shareholders of the Company | | | | **19,635** | 16,914 |
| Minority interest | | | | **(339)** | — |
| Profit for the year | | | | **19,296** | 16,914 |
| **Earnings per share** | | | | | |
| Basic | 10 | | | **21.89p** | 19.87p |
| Diluted | 10 | | | **21.04p** | 19.03p |

The 2012 'Total' column represents the IFRS reported results.

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

| | Note | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| Net result for the year | | **19,296** | 16,914 |
| Other comprehensive (expense)/income: | | | |
| Cash flow hedges: | | | |
| – losses arising in the year | 21 | **(1,311)** | (1,883) |
| – reclassification to Income Statement | 21 | **505** | 204 |
| Increase in deferred tax asset in respect of cash flow hedges | 21 | **152** | 420 |
| Actuarial (loss)/gain on defined benefit pension scheme | 26 | **(2,283)** | 846 |
| Increase/(decrease) in deferred tax asset in respect of defined benefit pension schemes | 22 | **381** | (479) |
| Other comprehensive expense for the year | | **(2,556)** | (892) |
| Total comprehensive income for the year | | **16,740** | 16,022 |
| **Attributable to:** | | | |
| Equity shareholders of the Company | | **17,079** | 16,022 |
| Minority interests | | **(339)** | — |
| Total comprehensive income for the year | | **16,740** | 16,022 |

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

| | Note | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current** | | | |
| Goodwill | 11 | **124,279** | 101,030 |
| Intangible assets | 12 | **39,365** | 26,449 |
| Property, plant and equipment | 13 | **15,981** | 12,681 |
| Pension and other employee benefits | 26 | **14,023** | — |
| Deferred tax asset | 22 | **15,428** | 7,379 |
| Trade and other receivables | 17 | **2,798** | 2,384 |
| | | **211,874** | 149,923 |
| **Current** | | | |
| Inventories | 15 | **11,833** | 12,541 |
| Trade and other receivables | 17 | **180,270** | 125,095 |
| Cash at bank and in hand | | **57,616** | 46,571 |
| | | **249,719** | 184,207 |
| **Total assets** | | **461,593** | 334,130 |
| **Equity** | | | |
| **Equity attributable to the shareholders of Mears Group PLC** | | | |
| Called up share capital | 23 | **919** | 857 |
| Share premium account | | **34,910** | 33,554 |
| Share-based payment reserve | | **1,685** | 2,965 |
| Hedging reserve | | **(1,913)** | (1,259) |
| Merger reserve | | **46,214** | 38,243 |
| Retained earnings | | **87,342** | 77,425 |
| **Total equity shareholders' funds** | | **169,157** | 151,785 |
| Minority interest | | **(339)** | — |
| **Total equity** | | **168,818** | 151,785 |
| **Liabilities** | | | |
| **Non-current** | | | |
| Long-term borrowing and overdrafts | | **55,000** | 55,000 |
| Pension and other employee benefits | 26 | **5,741** | 5,840 |
| Deferred tax liabilities | 22 | **11,488** | 5,297 |
| Financing liabilities | 19 | **1,823** | 1,325 |
| Other liabilities | 20 | **879** | 879 |
| | | **74,931** | 68,341 |
| **Current** | | | |
| Short-term borrowings and overdrafts | | **15,000** | 5,000 |
| Trade and other payables | 18 | **199,418** | 105,916 |
| Financing liabilities | 19 | **711** | 403 |
| Current tax liabilities | | **2,715** | 2,685 |
| **Current liabilities** | | **217,844** | 114,004 |
| **Total liabilities** | | **292,775** | 182,345 |
| **Total equity and liabilities** | | **461,593** | 334,130 |

The financial statements were approved and authorised for issue by the Board of Directors and were signed on its behalf on 9 April 2013.

**R Holt**
**Director**

**A C M Smith**
**Director**

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

| | Note | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Result for the year before tax | | **20,813** | 20,582 |
| Adjustments | 24 | **12,436** | 13,319 |
| Change in inventories | | **2,088** | (394) |
| Change in trade and other receivables | | **(16,900)** | (13,340) |
| Change in trade and other payables | | **18,618** | 5,753 |
| Cash flow from operating activities before taxation before effect of acquired contracts | | **37,055** | 25,920 |
| Change in working capital from acquired contracts | | **—** | (2,820) |
| Cash flow from operating activities before taxation | | **37,055** | 23,100 |
| Taxes paid | | **(3,343)** | (4,615) |
| Net cash inflow from operating activities | | **33,712** | 18,485 |
| **Investing activities** | | | |
| Additions to property, plant and equipment | | **(3,393)** | (3,991) |
| Additions to other intangible assets | | **(1,115)** | (1,419) |
| Proceeds from disposals of property, plant and equipment | | **27** | 208 |
| Acquisition of subsidiary undertaking, net of cash | | **(20,521)** | (5,771) |
| Interest received | | **11** | — |
| Net cash outflow from investing activities | | **(24,991)** | (10,973) |
| **Financing activities** | | | |
| Proceeds from share issue | | **1,389** | 320 |
| Discharge of finance lease liability | | **(38)** | (86) |
| Interest paid | | **(2,288)** | (2,970) |
| Dividends paid | | **(6,739)** | (5,962) |
| Net cash outflow from financing activities | | **(7,676)** | (8,698) |
| Cash and cash equivalents, beginning of year | | **(13,429)** | (12,243) |
| Net increase/(decrease) in cash and cash equivalents | | **1,045** | (1,186) |
| **Cash and cash equivalents, end of year** | | **(12,384)** | (13,429) |

| | | |
|---|---|---|
| Cash and cash equivalents comprises the following: | | |
| – cash at bank and in hand | **57,616** | 46,571 |
| – short-term borrowings and overdrafts | **(70,000)** | (60,000) |
| **Cash and cash equivalents** | **(12,384)** | (13,429) |

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

| | Attributable to equity shareholders of the Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital £'000 | Share premium account £'000 | Share-based payment reserve £'000 | Hedging reserve £'000 | Merger reserve £'000 | Retained earnings £'000 | Minority interests £'000 | Total equity £'000 |
| At 1 January 2011 | 848 | 33,243 | 2,905 | — | 38,243 | 66,315 | — | 141,554 |
| Net profit for the year | — | — | — | — | — | 16,914 | — | 16,914 |
| Other comprehensive (expense)/income | — | — | — | (1,259) | — | 367 | — | (892) |
| Total comprehensive income for the year | — | — | — | (1,259) | — | 17,281 | — | 16,022 |
| Deferred tax on share-based payments | — | — | — | — | — | (349) | — | (349) |
| Issue of shares | 9 | 311 | — | — | — | — | — | 320 |
| Share option charges | — | — | 200 | — | — | — | — | 200 |
| Exercise of share options | — | — | (140) | — | — | 140 | — | — |
| Dividends | — | — | — | — | — | (5,962) | — | (5,962) |
| At 1 January 2012 | 857 | 33,554 | 2,965 | (1,259) | 38,243 | 77,425 | — | 151,785 |
| Net profit for the year | — | — | — | — | — | 19,635 | (339) | 19,296 |
| Other comprehensive (expense)/income | — | — | — | (654) | — | (1,902) | — | (2,556) |
| **Total comprehensive income for the year** | — | — | — | (654) | — | 17,733 | (339) | 16,740 |
| Deferred tax on share-based payments | — | — | — | — | — | (2,607) | — | (2,607) |
| Issue of shares | 62 | 1,356 | — | — | 7,971 | — | — | 9,389 |
| Share option charges | — | — | 250 | — | — | — | — | 250 |
| Exercise of share options | — | — | (1,530) | — | — | (1,530) | — | — |
| Dividends | — | — | — | — | — | (6,739) | — | (6,739) |
| At 31 December 2012 | **919** | **34,910** | **1,685** | **(1,913)** | **46,214** | **87,342** | **(339)** | **168,818** |

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

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12–27 Review of the year
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## 1. Segment reporting

Segment information is presented in respect of the Group's operating segments. Segments are determined by reference to the internal reports reviewed by the Board.

The Group operated three operating segments during the year:

» Social Housing – services within this sector comprise a full repairs and maintenance service to Local Authorities and other Registered Social Landlords;

» Care – services within this sector comprise personal care services to people in their own homes; and

» Other – services within this sector comprise provision of design and build M&E services.

All of the Group's activities are carried out within the United Kingdom and the Group's principal reporting to its chief operating decision maker is not segmented by geography.

The principal financial measures used by the chief operating decision maker and the Board to review the performance of the operating segments is that of revenue growth and operating margins in both the core divisions of Social Housing and Care. The operating result utilised within the key performance measures is stated before amortisation of acquisition intangibles, exceptional costs and share-based payments.

| | **2012** | | | | 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| Operating segments | **Social Housing £'000** | **Care £'000** | **Other £'000** | **Total £'000** | Social Housing £'000 | Care £'000 | Other £'000 | Total £'000 |
| Revenue | **504,686** | **112,550** | **62,289** | **679,525** | 415,000 | 108,518 | 65,453 | 588,971 |
| Operating result pre amortisation of acquisition intangibles, exceptional costs and share-based payment | **23,962** | **9,302** | **(1,573)** | **31,691** | 23,866 | 8,674 | 1,268 | 33,808 |
| Operating margin pre amortisation of acquisition intangibles, exceptional costs and share-based payment | **4.8%** | **8.3%** | **(2.5%)** | **4.7%** | 5.8% | 8.0% | 1.9% | 5.7% |
| Share-based payment | **(210)** | **(15)** | **(25)** | **(250)** | (150) | (25) | (25) | (200) |
| Operating result pre amortisation of acquisition intangibles and exceptional costs | **23,752** | **9,287** | **(1,598)** | **31,441** | 23,716 | 8,649 | 1,243 | 33,608 |

All revenue and all non-current assets arise within the United Kingdom. All of the revenue reported is external to the Group. No revenue in respect of a single customer comprises more than 10% of the total revenue reported.

**Reconciliation to the Consolidated Income Statement**

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Operating result pre amortisation of acquisition intangibles and exceptional costs | **31,441** | 33,608 |
| Exceptional costs | **(2,877)** | (3,094) |
| Amortisation of acquisition intangibles | **(7,961)** | (7,783) |
| Finance costs, net | **210** | (2,149) |
| Tax expense | **(1,517)** | (3,668) |
| Net profit for the year | **19,296** | 16,914 |

## 1. Segment reporting continued

**Reconciliation to the Consolidated Income Statement** continued

In addition the following disclosures have been provided in respect of segmental analysis required by IFRS 8 'Operating Segments':

| | 2012 | | | | 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| Operating segments | Social Housing £'000 | Care £'000 | Other £'000 | Total £'000 | Social Housing £'000 | Care £'000 | Other £'000 | Total £'000 |
| Segment assets | 326,976 | 103,734 | 30,883 | 461,593 | 199,416 | 109,248 | 25,466 | 334,130 |
| Segment liabilities | (234,591) | (35,340) | (22,844) | (292,775) | (120,289) | (46,383) | (15,673) | (182,345) |
| Property, plant and equipment additions | 3,577 | 215 | 73 | 3,865 | 3,308 | 270 | 413 | 3,991 |
| Depreciation | 2,772 | 673 | 249 | 3,694 | 2,217 | 806 | 215 | 3,238 |
| Amortisation of acquisition intangibles | 4,967 | 2,994 | — | 7,961 | 4,992 | 2,791 | — | 7,783 |
| Finance income/(costs) | 1,529 | (1,104) | (215) | 210 | (991) | (1,132) | (26) | (2,149) |
| Profit before tax | 17,437 | 5,189 | (1,813) | 20,813 | 14,863 | 4,502 | 1,217 | 20,582 |

## 2. Profit for the year before tax

Profit for the year before tax is stated after:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Share-based payments | 250 | 200 |
| Depreciation | 3,694 | 3,238 |
| Amortisation | 8,913 | 8,404 |
| Hire of plant and machinery | 4,075 | 3,339 |
| Other operating lease rentals | 19,654 | 19,586 |

## 3. Auditor's remuneration

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Fees payable to the auditor for the audit of the Group's financial statements | 64 | 62 |
| Other fees payable to the auditor in respect of: | | |
| – auditing of accounts of subsidiary undertakings pursuant to legislation | 241 | 167 |
| – auditing of Group pension schemes | 17 | 6 |
| – taxation compliance fees | 43 | 59 |
| – taxation advice fees | — | 1 |
| Total auditor's remuneration | 365 | 295 |

## 4. Finance income and finance costs

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Interest charge on overdrafts and short-term loans | **(2,209)** | (1,994) |
| Interest charge on interest rate swap | **(505)** | (205) |
| Changes in mark-to-market of interest rate swaps (ineffective hedges) | **—** | (103) |
| Other interest | **(19)** | (86) |
| Finance costs on bank loans, overdrafts and finance leases | **(2,733)** | (2,388) |
| Interest charge on defined benefit obligation | **(144)** | (205) |
| Unwinding of discounting on deferred consideration | **(40)** | (40) |
| Total finance costs | **(2,917)** | (2,633) |
| Interest income resulting from short-term bank deposits | **11** | — |
| Interest income resulting from defined benefit obligation | **3,116** | 484 |
| Finance income | **3,127** | 484 |
| Net finance income/(charge) | **210** | (2,149) |
| Interest recognised in other comprehensive income | | |
| Changes in mark-to-market of interest rate swaps (effective hedges) | **(806)** | (1,679) |

## 5. Employees

Staff costs during the year were as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Wages and salaries | **220,144** | 205,462 |
| Social security costs | **18,496** | 17,758 |
| Other pension costs | **4,579** | 3,818 |
| | **243,219** | 227,038 |

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

| | 2012 Number | 2011 Number |
|---|---|---|
| Site workers | **3,237** | 2,926 |
| Carers | **5,734** | 5,983 |
| Office and management | **2,470** | 2,408 |
| | **11,441** | 11,317 |

Remuneration in respect of Directors was as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Emoluments | **1,273** | 1,351 |
| Gains made on the exercise of share options | **4,392** | 987 |
| Pension contributions to personal pension schemes | **185** | 190 |
| | **5,850** | 2,528 |

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

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Emoluments and gains made on the exercise of share options | **4,005** | 1,468 |
| Pension contributions to personal pension schemes | **75** | 105 |

During the year contributions were paid to personal pension schemes for four Directors (2011: four).

During the year two Directors (2011: one) exercised share options.

## 6. Share-based employee remuneration

As at 31 December 2012 the Group maintained six share-based payment schemes for employee remuneration.

Details of the share options outstanding (excluding those issued under the Special Incentive Plan (SIP)) are as follows:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Number '000 | Weighted average exercise price p | Number '000 | Weighted average exercise price p |
| Outstanding at 1 January | **5,842** | **85** | 7,502 | 75 |
| Granted | **1,353** | **178** | — | — |
| Forfeited/lapsed | **(1,141)** | **58** | (817) | 34 |
| Exercised | **(1,868)** | **41** | (843) | 37 |
| Outstanding at 31 December | **4,186** | **104** | 5,842 | 85 |

The weighted average share price at the date of exercise for share options exercised during the period was £2.22. The options outstanding at 31 December 2012, excluding the SIP Award, were exercisable at prices between 1p and 300p and had a weighted average remaining contractual life of six years.

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

The underlying expected share price volatility was determined by reference to historical data. The Company expects the volatility of its share price to reduce as it matures. The risk-free interest rate was determined by the implied yield available on a zero-coupon Government bond at the date of grant. Adjustments are made to reflect expected and actual forfeitures during the vesting period due to failure to satisfy service conditions. In the case of the SAYE scheme the expected forfeitures takes account of the requirement to save throughout the life of the scheme. There were 1.4m options granted during the year. 1.1m options lapsed during the year. The market price at 31 December 2012 was 328p and the range during 2012 was 216p to 335p.

At 31 December 2012, 3.8m options had vested and were still exercisable at a weighted average exercise price of 82p.

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

The Group recognises the following expenses related to share-based payments:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| LTIP | **157** | 120 |
| Approved share option plan | **—** | 1 |
| Unapproved share option plan | **(12)** | 40 |
| SAYE | **105** | 39 |
| SIP | **—** | — |
| | **250** | 200 |

In total, £0.25m of employee remuneration expense has been included in the Consolidated Income Statement for 2012 (2011: £0.20m), which gave rise to additional share-based payment reserves. No liabilities were recognised due to share-based payment transactions.

## 6. Share-based employee remuneration continued

### The Mears Group PLC Long-term Incentive Plan 2008 (LTIP)

The LTIP was introduced in October 2008 following shareholder approval. The award of options is offered to a small number of key Senior Management. The principal terms of the LTIP are detailed below:

Principal terms of LTIP

| | |
|---|---|
| Number of options | Maximum award limit under the plan will be 200% of salary p.a. |
| Exercise price | 1p |
| Performance period | 3 years |
| Performance conditions | There are two performance targets attaching to the LTIP Award. |
| | 50% of the LTIP Award will relate to an EPS growth target. The other 50% of the LTIP Award relates to the Company's TSR against the return of the FTSE All Share Support Services Sector. |
| Expiry conditions | Options are forfeited if the employee leaves the Group before the options have vested. |

Performance conditions of LTIP

| EPS growth target | | TSR target | |
|---|---|---|---|
| Performance levels | Level of vesting | Performance levels | Level of vesting |
| 10.0% | 10% | Below index return | 0% |
| 12.5% | 30% | Equal to index | 30% |
| 17.5% | 100% | 10% outperformance of the index p.a. | 100% |

### The Mears Group PLC Long-term Incentive Plan 2009 (LTIP)

The LTIP was introduced in October 2008 following shareholder approval. The award of options is offered to a small number of key Senior Management. The principal terms of the LTIP are detailed below:

Principal terms of LTIP

| | |
|---|---|
| Number of options | Maximum award limit under the plan will be 200% of salary p.a. |
| Exercise price | 1p |
| Performance period | 3 years |
| Performance conditions | There are two performance targets attaching to the LTIP Award. |
| | 75% of the LTIP Award will relate to an EPS growth target. The other 25% of the LTIP Award relates to the Company's TSR against the return of the FTSE All Share Support Services Sector. |
| Expiry conditions | Options are forfeited if the employee leaves the Group before the options have vested. |

Performance conditions of LTIP

| EPS growth target | | TSR target | |
|---|---|---|---|
| Performance levels | Level of vesting | Performance levels | Level of vesting |
| 10.0% | 10% | Below index return | 0% |
| 12.5% | 30% | Equal to index | 30% |
| 15.0% | 100% | 10% outperformance of the index p.a. | 100% |

## 6. Share-based employee remuneration continued

### The Mears Group PLC Long-term Incentive Plan 2010 (LTIP)

The LTIP was introduced in October 2008 following shareholder approval. The award of options is offered to a small number of key Senior Management. The principal terms of the LTIP are detailed below:

| Principal terms of LTIP | |
|---|---|
| Number of options | Maximum award limit under the plan will be 200% of salary p.a. |
| Exercise price | 1p |
| Performance period | 3 years |
| Performance conditions | There are two performance targets attaching to the LTIP Award. |
| | 75% of the LTIP Award will relate to an EPS growth target. The other 25% of the LTIP Award relates to the Company's TSR against the return of the FTSE All Share Support Services Sector. |
| Expiry conditions | Options are forfeited if the employee leaves the Group before the options have vested. |

Performance conditions of LTIP

| EPS growth target | | TSR target | |
|---|---|---|---|
| Performance levels | Level of vesting | Performance levels | Level of vesting |
| 10.0% | 10% | Below index return | 0% |
| 12.5% | 30% | Equal to index | 30% |
| 12.5% | 100% | 10% outperformance of the index p.a. | 100% |

### Approved share option plan

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

### Enterprise management incentive plan

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

### Unapproved share option plan

Options are exercisable at a price equal to the average quoted market price of the Company's shares on the three dealing days prior to the date of grant. The vesting period is three years. If the options remain unexercised after a period of ten years from the date of grant, the options expire. Options are forfeited if the employee leaves Mears Group before the options vest. With the introduction of the LTIP in 2008, the Remuneration Committee has decided that no further awards will be made under the unapproved share option plan.

### Save As You Earn (SAYE) scheme

Options are available to all employees. Options are granted for a period of either three or five years. Options are exercisable at a price based on the quoted market price of the Company's shares at the time of invitation, discounted by up to 20%. Options are forfeited if the employee leaves Mears Group before the options vest which impacts on the number of options expected to vest. If an employee stops saving but continues in employment, this is treated as a cancellation which results in an acceleration of the share-based payment charge.

## 6. Share-based employee remuneration continued

**Special Incentive Plan 2007 (SIP)**

The SIP was introduced in 2007 to reward the Chief Executive Officer with premium priced options linked to long-term performance. The terms and conditions were subsequently amended on 3 July 2009. The principal terms of the SIP and performance conditions are detailed below:

Principal terms of SIP

| | |
|---|---|
| Number of options | 2,500,000 of which 1,500,000 have been exercised and 1,000,000 remain exercisable |
| Exercise price | 1p |
| Performance conditions | Average real EPS growth attained over three financial years with the base period for calculating EPS being 31 December 2006. EPS was calculated before amortisation and IFRS 2 costs. The performance was measured at the end of the three-year period. The performance conditions relating to this award were satisfied in full. |
| Vesting conditions | The award vested in full in November 2010. 60% became exercisable in November 2010, 20% became exercisable in November 2011 and the remaining 20% became exercisable in November 2012. |

Performance conditions of SIP

| Performance levels | Level of vesting |
|---|---|
| 5% + RPI p.a. | 10% |
| 10% + RPI p.a. | 50% |
| 15% + RPI p.a. | 100% |

## 7. Exceptional costs

Exceptional costs incurred in the period which are considered non-trading or non-recurring in nature are detailed below:

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Costs of acquisitions | **830** | 224 |
| Costs of integration | **2,047** | — |
| Costs of refinancing | **—** | 890 |
| Costs relating to Photovoltaic (PV) | **—** | 1,980 |
| Exceptional costs | **2,877** | 3,094 |

The costs of acquisition in the current period relate to the acquisition of Morrison Facilities Services Limited. The costs of acquisition in the previous period relate to the acquisition of the Supported Living division of Choices Care Community Services Limited and the acquisition of the trade of the Home Improvement Agency division of Anchor Trust Limited.

The costs of integration in the period relate to the integration of the Morrison and Mears Social Housing businesses.

The costs of refinancing in the previous period relate to the write off of costs relating to the Group's previous facility.

The costs relating to PV arose as a direct result of the Government's decision to substantially reduce the PV Feed-in Tariff (FIT) subsidy. The Board took the decision to cease these activities immediately and wrote off costs relating to the site set-up, system design and installation amounting to £1.98m which are now considered irrecoverable.

## 8. Tax expense

**Tax recognised in the Income Statement:**

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| United Kingdom corporation tax effective rate 15.3% (2011: 22.1%) | **4,390** | 6,266 |
| Adjustment in respect of previous periods | **(698)** | (206) |
| Total current tax recognised in Income Statement | **3,692** | 6,060 |
| Deferred taxation charge: | | |
| – on defined benefit pension obligations | **926** | 215 |
| – on share-based payments | **18** | 54 |
| – on accelerated capital allowances | **(220)** | — |
| – on amortisation of acquisition intangibles | **(1,100)** | (2,661) |
| – on short-term temporary timing differences | **328** | — |
| – on corporate tax losses | **(1,773)** | — |
| – impact of change in statutory tax rates | **(354)** | — |
| Total deferred taxation recognised in Income Statement | **(2,175)** | (2,392) |
| Total tax expense recognised in Income Statement | **1,517** | 3,668 |
| Results for the year before tax | **20,813** | 20,582 |
| Result for the year multiplied by standard rate of corporation tax in the United Kingdom for the period of 24.5% (2011: 26.5%) | **5,099** | 5,454 |
| Effect of: | | |
| – expenses not deductible for tax purposes | **1,080** | 162 |
| – income not subject to tax | **—** | (679) |
| – capital allowances in excess of depreciation | **(104)** | 116 |
| – tax relief on exercise of share options | **(1,682)** | (423) |
| – statutory tax rate changes | **(426)** | (749) |
| – tax rate difference | **(5)** | (7) |
| – utilisation of tax losses | **(229)** | — |
| – tax losses provided | **(1,518)** | — |
| – adjustment in respect of prior periods | **(698)** | (206) |
| Actual tax expense, net | **1,517** | 3,668 |
| Deferred tax recognised in other comprehensive income | | |
| – on defined benefit pension obligations | **(524)** | 479 |
| – on cash flow hedges | **(185)** | (420) |
| – impact of change in statutory tax rates | **176** | — |
| Total deferred taxation recognised in other comprehensive income | **(533)** | 59 |
| Deferred tax recognised directly in equity | | |
| Deferred taxation charge: | | |
| – on share-based payments | **2,239** | 349 |
| – impact of change in statutory tax rates | **368** | — |
| Total deferred taxation recognised in equity | **2,607** | 349 |
| Total tax | | |
| Total current tax | **3,692** | 6,060 |
| Total deferred tax | **(100)** | (1,984) |

## 9. Dividends

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

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Final 2011 dividend of 5.35p (2011: final 2010 dividend of 4.85p) per share | **4,698** | 4,123 |
| Interim 2012 dividend of 2.30p (2011: interim 2011 dividend of 2.15p) per share | **2,041** | 1,839 |
| | **6,739** | 5,962 |

The proposed final 2012 dividend of 5.70p per share has not been included within the consolidated financial statements as no obligation existed at 31 December 2012.

## 10. Earnings per share

| | Basic | | Diluted | |
|---|---|---|---|---|
| | 2012 p | 2011 p | 2012 p | 2011 p |
| Earnings per share | **21.89** | 19.87 | **21.04** | 19.03 |
| Effect of amortisation of acquisition intangibles | **9.03** | 9.14 | **8.68** | 8.75 |
| Effect of full tax adjustment | **(6.28)** | (4.52) | **(6.03)** | (4.33) |
| Effect of exceptional costs (including tax impact) | **2.47** | 2.67 | **2.37** | 2.56 |
| Normalised earnings per share | **27.11** | 27.16 | **26.06** | 26.01 |
| Effect of Morrison acquisition | **1.77** | — | **1.69** | — |
| Normalised earnings per share before losses generated by the Morrison acquisition | **28.88** | 27.16 | **27.75** | 26.01 |

A normalised EPS is disclosed in order to show performance undistorted by amortisation of intangibles. The Group defines normalised earnings as excluding the amortisation of acquisition intangibles, exceptional costs and adjusted to reflect a full tax charge of 24.5%. The profit attributable to shareholders before and after adjustments for both basic and diluted EPS is:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Profit attributable to shareholders: | **19,296** | 16,914 |
| – amortisation of acquisition intangibles | **7,961** | 7,783 |
| – full tax adjustment | **(5,535)** | (3,848) |
| – exceptional costs (including tax impact) | **2,172** | 2,274 |
| Normalised earnings | **23,894** | 23,123 |
| – Morrison acquisition (including tax impact) | **1,436** | — |
| Normalised earnings before losses generated by the Morrison acquisition | **25,330** | 23,123 |

The calculation of EPS is based on a weighted average of ordinary shares in issue during the year. The diluted EPS is based on a weighted average of ordinary shares calculated in accordance with IAS 33 'Earnings Per Share', which assumes that all dilutive options will be exercised. The additional normalised basic and diluted EPS use the same weighted average number of shares as the basic and diluted EPS.

| | 2012 Millions | 2011 Millions |
|---|---|---|
| Weighted average number of shares in issue: | **88.14** | 85.14 |
| – dilutive effect of share options | **3.57** | 3.75 |
| Weighted average number of shares for calculating diluted earnings per share | **91.71** | 88.89 |

The weighted average number of shares in issue, excluding those issued in respect of the acquisition of Morrison, was 87.73m and the weighted average number of shares for calculating diluted earnings per share, excluding those issued in respect of the acquisition of Morrison, was 91.29m.

## 11. Goodwill

| | Goodwill arising on consolidation £'000 | Purchased goodwill £'000 | Total £'000 |
|---|---|---|---|
| **Gross carrying amount** | | | |
| At 1 January 2011 | 96,999 | 406 | 97,405 |
| Additions | 3,593 | — | 3,593 |
| Revision | 32 | — | 32 |
| At 1 January 2012 | 100,624 | 406 | 101,030 |
| Additions | 23,208 | — | 23,208 |
| Revision | 41 | — | 41 |
| **At 31 December 2012** | **123,873** | **406** | **124,279** |
| **Accumulated impairment losses** | | | |
| At 1 January 2011, at 1 January 2012 and at 31 December 2012 | — | — | — |
| **Carrying amount** | | | |
| **At 31 December 2012** | **123,873** | **406** | **124,279** |
| At 31 December 2011 | 100,624 | 406 | 101,030 |

Goodwill on consolidation arises on the excess of cost of acquisition over the fair value of the net assets acquired on purchase of a company.

Purchased goodwill arises on the excess of cost of acquisition over the fair value of the net assets acquired on the purchase of the trade and assets of a business by the Company.

Additions to goodwill arising on consolidation are detailed within note 25.

Revisions totalling £0.04m relate to reductions to the estimated fair value of assets acquired and a reduction in consideration payable. The reduction in fair value of assets acquired relates to costs not accrued at the time of the acquisition. The revisions are not considered sufficiently material to warrant the restatement of the prior year provisional balances.

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

The carrying value of goodwill is primarily comprised of the following CGUs:

| | Goodwill arising on consolidation £'000 | Purchased goodwill £'000 | Total £'000 |
|---|---|---|---|
| Social Housing | 46,048 | 406 | 46,454 |
| Care | 77,825 | — | 77,825 |
| Other Services | — | — | — |
| | **123,873** | **406** | **124,279** |

An asset is impaired if its carrying value exceeds the unit's recoverable amount which is based upon value in use. At 31 December 2012 impairment reviews were performed by comparing the carrying value of the CGU with the value in use of the CGUs to which goodwill has been allocated. The value in use is calculated based upon the cash flow projections of the latest one-year budget forecast extrapolated for nine years by a growth rate applicable to each unit and an appropriate terminal value based on a perpetuity.

## 11. Goodwill continued

The rates used were as follows:

| | Post tax discount rate | Pre tax discount rate | Growth rates (years 1–2) | Growth rates (years 3–5) | Terminal growth rate |
|---|---|---|---|---|---|
| Social Housing | 9.9% | 12.0% | 5.0% | 5.0% | 2.5% |
| Care | 9.7% | 11.8% | — | 5.0% | 2.5% |

The estimated growth rates are based on past experience and knowledge of the individual sector's markets.

### Social Housing

The contracts awarded within the Social Housing area are significant in size and the contract terms are typically three to ten years in duration. The record of Mears in retaining contracts on expiry is typically over 90%. The impairment reviews have always taken a particularly prudent stance and incorporated a minimal growth assumption, which whilst marginally higher than the UK long-term growth rate of 2.25% is supported by historic organic growth.

Budgeted operating profits during the budget period are estimated by reference to the average operating margins achieved in the period immediately before the start of the budget period. There is no inclusion for any anticipated efficiency improvements.

The Directors consider that reasonably possible changes in these key assumptions would not cause a unit's carrying amount to exceed its recoverable amount.

### Care

The care-at-home market will continue to present strong growth opportunities. The Directors believe that future growth is underpinned by a number of factors including:

- the number of people aged over 65, who make up the bulk of care expenditure, is forecast to grow with a Compound Annual Growth Rate (CAGR) of 3.3% between 2010 and 2021;
- the NHS is tasked with investing more in Continuing Health Care (CHC) spend in the community and with joining up its services with Social Care. CHC had a 12% CAGR between 2009 and 2012 and this is expected to continue. There are an increasing number of areas with joint commissioning between the NHS and Social Care, with the newly established Health and Well Being Boards being encouraged to continue this process of integration against clearly agreed local priorities;
- residential care remains a more expensive solution and one that is generally less preferred by service users. Given the considerable financial challenges facing the UK economy, care at home will benefit from this situation;
- continued policy directives, referencing the Dilnot Report, are supporting increased spend on care services, the most recent announcement being a £75k cap on the amount an individual will have to spend on funding their own care in the future. This will enable the development of more cost effective insurance products for those people wanting to protect themselves against paying for their own care in the future;
- there is rising political concern about the current underfunding of the sector, which management believes will lead to further funding announcements in the future; and
- a little over 10% of the market continues to be delivered by Local Authority in-house services; however, in parts of the country, notably Scotland, this is as high as 50%. Mears has been growing its presence within the areas which currently have high levels of in-sourcing. Given the lower costs within the private sector, further outsourcing is very likely.

The impairment reviews have incorporated no growth in years one and two and a growth assumption of 5.0% in years three to five, which the Directors believe to be realistic given the impact and timing of the factors noted above. The terminal growth rate of 2.5%, whilst marginally higher than the UK long-term growth rate of 2.25%, is considered appropriate based on the factors noted above.

Budgeted operating profits during the budget period are estimated by reference to the average operating margins achieved in the period immediately before the start of the budget period. There is no inclusion for any anticipated efficiency improvements.

## 11. Goodwill continued

**Care** continued

The Directors consider that the Care value in use is most sensitive to changes in the terminal growth rate. The sensitivity of the calculated value in use to changes in explicit growth rate, terminal growth rate and discount rate is shown in the table below. The shaded values indicate situations which would result in impairment.

The table below shows the sensitivity (£'000) to simultaneous changes in the discount rate and the long-term growth rate.

| | Terminal growth rate | | | | |
|---|---|---|---|---|---|
| Discount rate | 1.50% | 2.00% | 2.50% | 3.00% | 3.50% |
| 7.7% | 31,773 | 39,783 | 49,333 | 60,915 | 75,255 |
| 8.2% | 22,698 | 29,361 | 37,192 | 46,530 | 57,854 |
| 8.7% | 14,885 | 20,496 | 24,311 | 34,669 | 43,799 |
| 9.2% | 8,089 | 12,863 | 18,349 | 24,720 | 32,209 |
| 9.7% | 2,122 | 6,222 | **10,891** | 16,257 | 22,488 |
| 10.2% | (3,157) | 392 | 4,402 | 8,969 | 14,217 |
| 10.7% | (7,861) | (4,767) | (1,295) | 2,628 | 7,095 |
| 11.2% | (12,080) | (9,364) | (6,337) | (2,941) | 897 |
| 11.7% | (15,884) | (13,487) | (10,831) | (7,869) | (4,546) |

It is only when a simultaneous unfavourable change of greater than 0.5% occurs in both the terminal growth rate and the discount rate that the headroom falls below zero.

The table below shows sensitivity (£'000) to simultaneous changes in the explicit growth rate (2013–2017) and the long-term growth rate.

| | Terminal growth rate | | | | |
|---|---|---|---|---|---|
| 2013–2017 annual growth rate | 1.50% | 2.00% | 2.50% | 3.00% | 3.50% |
| 3.0% | (3,247) | 545 | 4,864 | 9,828 | 15,592 |
| 3.5% | (1,932) | 1,935 | 6,340 | 11,402 | 17,281 |
| 4.0% | (599) | 3,345 | 7,836 | 12,998 | 18,993 |
| 4.5% | 752 | 4,774 | 9,353 | 14,616 | 20,728 |
| 5.0% | 2,122 | 6,222 | **10,891** | 16,257 | 22,488 |
| 5.5% | 3,511 | 7,690 | 12,450 | 17,922 | 24,272 |
| 6.0% | 4,918 | 9,179 | 14,030 | 19,606 | 26,081 |
| 6.5% | 6,345 | 10,687 | 15,632 | 21,315 | 27,915 |
| 7.0% | 7,791 | 12,216 | 17,256 | 23,047 | 29,773 |

It is only when an unfavourable change of greater than approximately 1.0% occurs in the terminal growth rate combined with an unfavourable change of 0.5% combined with an unfavourable change in the explicit forecast period growth rate of 1.0% that the headroom falls below zero.

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## 12. Other intangible assets

| | Acquisition intangibles | | | Other intangibles | | | |
|---|---|---|---|---|---|---|---|
| | Client relationships £'000 | Order book £'000 | Total acquisition intangibles £'000 | Development expenditure £'000 | Intellectual property £'000 | Total other intangibles £'000 | Total intangibles £'000 |
| **Gross carrying amount** | | | | | | | |
| At 1 January 2011 | 31,732 | 13,549 | 45,281 | 2,656 | 224 | 2,880 | 48,161 |
| Acquired on acquisition | 4,214 | — | 4,214 | — | — | — | 4,214 |
| Revision | 2,084 | — | 2,084 | — | — | — | 2,084 |
| Additions | — | — | — | 1,419 | — | 1,419 | 1,419 |
| At 1 January 2012 | 38,030 | 13,549 | 51,579 | 4,075 | 224 | 4,299 | 55,878 |
| Acquired on acquisition | 20,714 | — | 20,714 | — | — | — | 20,714 |
| Additions | — | — | — | 1,115 | — | 1,115 | 1,115 |
| **At 31 December 2012** | **58,744** | **13,549** | **72,293** | **5,190** | **224** | **5,414** | **77,707** |
| **Accumulated amortisation** | | | | | | | |
| At 1 January 2011 | 13,480 | 6,752 | 20,232 | 703 | 90 | 793 | 21,025 |
| Amortisation charge for period | 5,535 | 2,248 | 7,783 | 577 | 44 | 621 | 8,404 |
| At 1 January 2012 | 19,015 | 9,000 | 28,015 | 1,280 | 134 | 1,414 | 29,429 |
| Amortisation charge for period | 7,811 | 150 | 7,961 | 908 | 44 | 952 | 8,913 |
| **At 31 December 2012** | **26,826** | **9,150** | **35,976** | **2,188** | **178** | **2,366** | **38,342** |
| **Carrying amount** | | | | | | | |
| **At 31 December 2012** | **31,918** | **4,399** | **36,317** | **3,002** | **46** | **3,048** | **39,365** |
| At 31 December 2011 | 19,015 | 4,549 | 23,564 | 2,795 | 90 | 2,885 | 26,449 |

Development expenditure relates to the development of the Group's Social Housing job management system and the Group's Care management system. Development expenditure is amortised over its useful economic life of 5.0 years. The weighted average remaining economic life of the asset is 3.7 years (2011: 4.1 years).

Intellectual property is amortised over its useful economic life of 5.0 years. The weighted average remaining economic life is one year.

Amortisation of development expenditure is included within other administrative expenses. Amortisation of acquisition intangibles is disclosed individually.

The value placed on the order book is based upon the cash flow projections over the contracts in place when a business is acquired. Due to uncertainties with trying to forecast revenues beyond the contract term, the Directors have taken a measure of prudence and value contracts over the contractual term only. The value of the order book is amortised over its remaining life.

The value placed on the customer relationships are based upon the non-contractual expected cash inflows. These cash flow projections assume a customer attrition rate of 5% based upon three-year historic trends.

Additions to intangible assets arising on acquisition are detailed within note 25.

Revisions in the previous year totalling £2.1m relate to reductions to the estimated fair value of assets acquired previously. A reduction in fair value of assets acquired in respect of the acquisition of Jackson Lloyd Limited of £1.8m relates to provisions and costs not accrued at the time of the acquisition. A reduction of fair value of net assets acquired in respect of the acquisition of the social housing business assets of the Bristol social housing division of Rok Building Limited of £0.3m relates to costs not accrued at the time of the acquisition. The revisions were not considered sufficiently material to warrant the restatement of the prior year provisional balances.

## 13. Property, plant and equipment

| | Leasehold improvements £'000 | Plant and machinery £'000 | Fixtures, fittings and equipment £'000 | Motor vehicles £'000 | Total £'000 |
|---|---|---|---|---|---|
| Gross carrying amount | | | | | |
| At 1 January 2011 | 7,370 | 2,852 | 19,700 | 2,689 | 32,611 |
| Additions | 1,407 | 336 | 2,231 | 17 | 3,991 |
| Disposals | (564) | — | — | (1,335) | (1,899) |
| At 1 January 2012 | 8,213 | 3,188 | 21,931 | 1,371 | 34,703 |
| Acquired on acquisition | 803 | 1,263 | 15,514 | — | 17,580 |
| Additions | 646 | 611 | 2,608 | — | 3,865 |
| Disposals | (184) | — | (55) | (148) | (387) |
| **At 31 December 2012** | **9,478** | **5,062** | **39,998** | **1,223** | **55,761** |
| Depreciation | | | | | |
| At 1 January 2011 | 3,608 | 2,149 | 12,455 | 2,286 | 20,498 |
| Provided in the year | 916 | 168 | 2,085 | 69 | 3,238 |
| Eliminated on disposals | (564) | — | — | (1,150) | (1,714) |
| At 1 January 2012 | 3,960 | 2,317 | 14,540 | 1,205 | 22,022 |
| Acquired on acquisition | 305 | 1,072 | 13,031 | — | 14,408 |
| Provided in the year | 922 | 353 | 2,381 | 38 | 3,694 |
| Eliminated on disposals | (184) | — | (40) | (120) | (344) |
| **At 31 December 2012** | **5,003** | **3,742** | **29,912** | **1,123** | **39,780** |
| Carrying amount | | | | | |
| **At 31 December 2012** | **4,475** | **1,320** | **10,086** | **100** | **15,981** |
| At 31 December 2011 | 4,253 | 871 | 7,391 | 166 | 12,681 |

## 14. Investments

The principal undertakings within the Group at 31 December 2012 are shown below:

| | Proportion held | Nature of business |
|---|---|---|
| Mears Limited | 100% | Provision of maintenance services |
| Haydon Mechanical & Electrical Limited | 100% | Provision of M&E services |
| Scion Technical Services Limited | 100% | Provision of maintenance services |
| Scion Estates Limited | 100% | Provision of grounds maintenance |
| Jackson Lloyd Limited | 100% | Provision of maintenance services |
| Morrison Facilities Services Limited | 100% | Provision of maintenance services |
| Morrison Scotland LLP | 66.7% | Provision of maintenance services |
| Manchester Working Limited | 80% | Provision of maintenance services |
| Mears Home Improvements Limited | 100% | Provision of maintenance services |
| Mears Care Limited | 100% | Provision of care |
| Mears Care (Northern Ireland) Limited | 100% | Provision of care |
| Mears Care (Scotland) Limited | 100% | Provision of care |
| Terraquest Solutions Limited | 100% | Provision of professional services |
| Mears Insurance Company Limited | 99.99% | Provision of insurance services |

All material subsidiary undertakings prepare accounts to 31 December. All material subsidiary undertakings are registered in England and Wales with the exception of Mears Insurance Captive Limited, which is registered in Guernsey, Mears Care (Northern Ireland), which is registered in Northern Ireland, and Mears Care (Scotland), which is registered in Scotland.

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

## 15. Inventories

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Materials and consumables | **2,634** | 2,411 |
| Work in progress | **9,199** | 10,130 |
| | **11,833** | 12,541 |

The Group consumed inventories totalling £495.6m during the year (2011: £414.2m). No items are being carried at fair value less costs to sell (2011: £nil).

## 16. Construction contracts

Revenue of £62.3m (2011: £74.2m) relating to construction contracts has been included in the Consolidated Income Statement.

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Contract costs incurred | **56,790** | 59,368 |
| Recognised gross profits | **5,499** | 14,829 |
| Recognised gross losses | **—** | — |
| | **62,289** | 74,197 |
| Balances outstanding comprise: | | |
| – retentions | **5,710** | 4,965 |
| – due from customers for construction contract work | **6,395** | 5,799 |
| – due to customers for construction contract work | **(1,044)** | (750) |

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

## 17. Trade and other receivables

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Current assets: | | |
| – trade receivables | **69,416** | 56,940 |
| – amounts recoverable on construction contracts | **6,395** | 5,799 |
| – amounts recoverable on non-construction contracts | **92,927** | 57,880 |
| – prepayments and accrued income | **11,532** | 4,476 |
| | **180,270** | 125,095 |
| Non-current assets: | | |
| – trade receivables | **2,798** | 2,384 |
| Total trade and other receivables | **183,068** | 127,479 |

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. Social Housing customers are typically Local Authorities and Housing Associations where credit risk is minimal. Care customers are typically County Councils where credit risk is minimal. Included in trade receivables is an amount of £2.8m (2011: £2.4m) which is due after more than one year and represents retention balances.

## 17. Trade and other receivables continued

The ageing analysis of trade receivables is as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Neither impaired nor past due | **56,096** | 49,831 |
| Less than three months past due but not impaired | **10,926** | 6,246 |
| More than three months but not impaired | **5,192** | 3,247 |
| Total trade and other receivables | **72,214** | 59,324 |

## 18. Trade and other payables

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Trade payables | **91,572** | 67,898 |
| Accruals and deferred income | **64,190** | 14,502 |
| Social security and other taxes | **23,329** | 17,464 |
| Due to customers for construction contract work | **1,044** | 750 |
| Due to customers for non-construction contract work | **520** | 684 |
| Other creditors | **18,763** | 4,580 |
| Amounts due under finance lease contracts | **—** | 38 |
| | **199,418** | 105,916 |

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.

Included in other creditors is £0.46m (2011: £1.98m) relating to contingent consideration on acquisitions.

## 19. Financing liabilities

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Current liabilities: | | |
| – interest rate swaps | **711** | 403 |
| | **711** | 403 |
| Non-current liabilities: | | |
| – interest rate swaps | **1,823** | 1,325 |
| Total financing liabilities | **2,534** | 1,728 |

## 20. Long-term other liabilities

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Other creditors | **879** | 879 |

Included in other creditors is £0.88m (2011: £0.88m) relating to contingent consideration on acquisitions.

## 21. Financial instruments

The Group uses a limited number of financial instruments comprising cash and liquid resources, borrowings, interest rate swaps and various items such as trade receivables and trade payables that arise directly from its operations. The main purpose of these financial instruments is to finance the Group's operations. The Group seeks to finance its operations through a combination of retained earnings and borrowings and investing surplus cash on deposit. The Group uses financial instruments to manage the interest rate risks arising from its operations and sources of finance but has no interests in the trade of financial instruments.

### Categories of financial instruments

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Financial assets | | |
| Loans and receivables | | |
| Trade receivables | **72,214** | 59,324 |
| Amounts recoverable on contracts | **99,322** | 63,679 |
| Cash at bank and in hand | **57,616** | 46,571 |
| | **229,152** | 169,574 |
| Financial liabilities | | |
| Fair value (level 2) | | |
| Interest rate swaps – ineffective | **—** | — |
| Interest rate swaps – effective | **(2,534)** | (1,728) |
| Amortised cost | | |
| Bank borrowings and overdrafts | **(70,000)** | (60,000) |
| Contingent consideration in respect of acquisitions | **(1,501)** | (2,861) |
| Trade payables | **(91,572)** | (67,898) |
| Accruals | **(64,190)** | (14,502) |
| Other creditors | **(18,141)** | (2,598) |
| | **(247,938)** | (149,587) |
| | **(18,786)** | 19,987 |

The IFRS 7 level categorisation relates to the extent the fair value can be determined by reference to comparable market values. The classifications range from level 1, where instruments are quoted on an active market, through to level 3, where the assumptions used to arrive at fair value do not have comparable market data. The fair values of interest rate swaps have been calculated by a third party expert discounting estimated future cash flows on the basis of market expectations of future interest rates (level 2). There have been no transfers between levels during the year.

### Fair value information

The fair value of the Group's financial assets and liabilities is as disclosed above and equals the book value with the exception of the contingent consideration in respect of acquisitions where the book value is £1.2m.

### Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including interest rate risk and price risk); credit risk; and liquidity risk. The main risks faced by the Group relate to the availability of funds to meet business needs and the risk of credit default by customers. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

Risk management is carried out under policies and guidelines approved by the Board of Directors.

## 21. Financial instruments continued

### Borrowing facilities

The Group's borrowing facilities are drawn on as required to manage its cash needs. Banking facilities are reviewed regularly and extended and replaced in advance of their expiry.

The Group had total borrowing facilities of £120m with Barclays Bank PLC and HSBC plc, of which £70m was utilised at 31 December 2012.

The facilities comprise a committed five-year £110.0m revolving credit facility and an unsecured overdraft facility of £10.0m. The undrawn amounts at 31 December 2012 were a £40.0m revolving credit facility and overdraft facility of £10.0m.

### Interest rate risk management

The Group finances its operations through a mixture of retained profits and bank borrowings from major banking institutions at floating rates of interest based on LIBOR. The Group's exposure to interest rates fluctuations on borrowings is managed through the use of interest rate swaps; hence the fixed rate borrowings relate to floating rate loans where the interest rate has been fixed by a hedging arrangement. The fair value of interest rate exposure on financial liabilities of the Group as at 31 December 2012 was:

| | Interest rate | | | |
|---|---|---|---|---|
| | Fixed £'000 | Floating £'000 | Zero £'000 | Total £'000 |
| **Financial liabilities – 2012** | **55,000** | **15,000** | **1,501** | **71,501** |
| Financial liabilities – 2011 | 55,038 | 5,000 | 2,861 | 62,899 |

The Group's policy is to accept a degree of interest rate risk, provided the effects of the various potential changes in rates remain within certain prescribed parameters.

Accordingly, the Group has hedged the first £55m of the £120m revolving credit facility by entering into interest rate swap arrangements with Barclays Bank PLC and HSBC plc. This consists of two £27.5m swap contracts expiring in August 2016 with quarterly maturity, matching the underlying facility. The Group has designated this as two separate hedges of £45m and £10m respectively of the underlying borrowing for the purpose of hedge accounting under IAS 39.

The maturity of the interest rate swap contracts is as follows:

| | **2012** | | 2011 | |
|---|---|---|---|---|
| | **Nominal amount hedged £'000** | **Applicable interest rates %** | Nominal amount hedged £'000 | Applicable interest rates % |
| Within one year | **—** | **—** | — | — |
| 1–2 years | **—** | **—** | — | — |
| 2–5 years | **55,000** | **1.95%** | 55,000 | 1.95% |
| More than five years | **—** | **—** | — | — |

### Effective interest rates

Interest rate swaps with fair value liabilities of £2.5m (2011: £1.7m) and remaining lives of three years and eight months have been accounted for in creditors.

The Group's overall average cost of debt, including effective and ineffective interest rate swaps, is 3.3% as at 31 December 2012 (2011: 3.6%). Excluding these swaps the average is 2.6% (2011: 2.8%).

### Cash flow hedging reserve

The cash flow hedging reserve comprises all gains and losses arising from the valuation of interest swap contracts which are effective hedges and mature after the year end. These are valued on a mark-to-market basis, are accounted for through the Statement of Comprehensive Income and are recycled through the Consolidated Income Statement when the hedged item affects the Consolidated Income Statement. The interest rate swap contracts have quarterly maturity and expires in August 2016.

## 21. Financial instruments continued

### Cash flow hedging reserve continued

Movements during the year were:

| | £'000 |
|---|---|
| At 1 January 2011 | — |
| Amounts transferred to the Consolidated Income Statement | 204 |
| Revaluations during the year | (1,883) |
| Deferred tax movement | 420 |
| At 1 January 2012 | (1,259) |
| Amounts transferred to the Consolidated Income Statement | 505 |
| Revaluations during the year | (1,311) |
| Deferred tax movement | 152 |
| **At 31 December 2012** | **(1,913)** |

At 31 December 2012 the Group had minimal exposure to movement in interest rates as the remaining interest rate risk was offset by the Group's cash and short-term deposits.

If the interest rates had been 0.5% higher or lower and all other variables were held constant, the Group's profit before taxation for the year ended 31 December 2012 and reserves would decrease or increase, respectively, by £0.1m.

### Liquidity risk management

The main financial risks of the Group relate to the availability of funds to meet business needs.

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

Management monitors rolling forecasts of the Group's liquidity reserve (comprising undrawn borrowing facilities and cash and cash equivalents) on the basis of expected cash flows. This is generally carried out at a local level in the operating companies of the Group in accordance with practice and limits set by the Group. These limits vary by location and take into account the liquidity and nature of the market in which the entity operates.

The quantum of committed borrowing facilities of the Group is regularly reviewed and is designed to exceed forecasted peak gross debt levels. For short-term working capital purposes, the Group utilises bank overdrafts as required. These facilities are regularly reviewed and are renegotiated ahead of their expiry date.

The table below shows the maturity profile of the Group's financial liabilities:

| | Within 1 year £'000 | 1–2 years £'000 | 2–5 years £'000 | Over 5 years £'000 | Total £'000 |
|---|---|---|---|---|---|
| 2012 | | | | | |
| Non-derivative financial liabilities: | | | | | |
| Bank borrowings | **15,000** | **—** | **55,000** | **—** | **70,000** |
| Contingent consideration in respect of acquisitions | **461** | **879** | **—** | **—** | **1,340** |
| Derivative financial liabilities: | | | | | |
| Interest rate swaps – effective | **711** | **663** | **1,160** | **—** | **2,534** |
| Interest rate swaps – ineffective | **—** | **—** | **—** | **—** | **—** |
| 2011 | | | | | |
| Non-derivative financial liabilities: | | | | | |
| Bank borrowings | 5,000 | — | 55,000 | — | 60,000 |
| Finance leases | 38 | — | — | — | 38 |
| Contingent consideration in respect of acquisitions | 1,861 | 879 | — | — | 2,740 |
| Derivative financial liabilities: | | | | | |
| Interest rate swaps – effective | 403 | 354 | 971 | — | 1,728 |
| Interest rate swaps – ineffective | — | — | — | — | — |

The Group has disclosed core bank borrowings of £55m as due in two to five years. Whilst the amounts borrowed could be repaid each quarter, the Group's intention is to align core bank borrowings with its interest rate swaps.

## 21. Financial instruments continued

### Credit risk management

The Group's credit risk is primarily attributable to its trade receivables, amounts recoverable on contracts and work in progress. The amounts presented in the Balance Sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and the current economic environment.

Trade receivables are normally due within 30 to 60 days. Trade and other receivables included in the Balance Sheet are stated net of a bad debt provision which has been estimated by management following a review of individual receivable accounts. There is no Group-wide rate of provision and provision made for debts that are overdue is based on prior default experience and known factors at the balance sheet date. Receivables are written off against the bad debt provision when management considers that the debt is no longer recoverable.

Social Housing customers are typically Local Authorities and Housing Associations. Care customers are typically County Councils. The nature of both of these customers means that credit risk is minimal. M&E customers are typically large main contractors. Other trade receivables contain no specific concentration of credit risk as the amounts recognised represent a large number of receivables from various customers.

The Group continually monitors the position of major customers and incorporates this information into its credit risk controls. External credit ratings are obtained where appropriate.

Details of the ageing of trade receivables are shown in note 17.

### Contingent consideration

The table below shows the movements in contingent consideration:

| | Total £'000 |
|---|---|
| At 1 January 2011 | 2,820 |
| Increase due to new acquisitions in the year | 400 |
| Paid in respect of acquisitions | (399) |
| Unwinding of discounting | 40 |
| At 1 January 2012 | 2,861 |
| Released to operating profit on reassessment of contingent consideration | (1,400) |
| Unwinding of discounting | 40 |
| At 31 December 2012 | **1,501** |

Contingent consideration represents an estimate of future consideration likely to be payable in respect of acquisitions. Contingent consideration is discounted for the likelihood of payment and for the time value of money. Contingent consideration becomes payable based upon the profitability of acquired businesses or in the case of one specific acquisition the utilisation of certain timing differences in respect of corporation tax.

Information as to the likely timing of payments in respect of these provisions is provided earlier within this note.

### Capital maintenance

The Group's objectives when managing capital are:

- to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- to provide an adequate return to shareholders by pricing products and services commensurately with the level of risk; and
- to maintain an optimal capital structure to reduce the cost of capital.

The Group sets the amount of capital in proportion to risk. The Group manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The capital structure of the Group consists of net funds as disclosed below and equity as disclosed in the Consolidated Statement of Changes in Equity.

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Cash and cash equivalents is comprised as follows: | | |
| – cash at bank and in hand | **57,616** | 46,571 |
| – bank borrowings and overdrafts | **(70,000)** | (60,000) |
| Cash and cash equivalents | **(12,384)** | (13,429) |

## 22. Deferred taxation

Deferred tax is calculated on temporary differences under the liability method.

### Deferred tax asset

The Group asset for deferred tax as at 31 December 2012 is £16.1m (2011: £7.4m).

| | Pension scheme £'000 | Share-based payments £'000 | Cash flow hedges £'000 | Tax losses £'000 | Short-term temporary differences £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| At 1 January 2011 | 2,154 | 5,902 | — | — | — | 8,056 |
| Debit to Income Statement | (215) | (54) | — | — | — | (269) |
| (Debit)/credit to Consolidated Statement of Changes in Equity | — | (349) | 420 | — | — | 71 |
| Debit to Consolidated Statement of Comprehensive Income | (479) | — | — | — | — | (479) |
| At 1 January 2012 | 1,460 | 5,499 | 420 | — | — | 7,379 |
| Acquired on acquisition | 413 | — | — | 5,360 | 4,009 | 9,782 |
| (Debit)/credit to Income Statement | (926) | (91) | — | 1,774 | (408) | 349 |
| (Debit)/credit to Consolidated Statement of Changes in Equity | — | (2,607) | 151 | — | — | (2,456) |
| Credit to Consolidated Statement of Comprehensive Income | 374 | — | — | — | — | 374 |
| **At 31 December 2012** | **1,321** | **2,801** | **571** | **7,134** | **3,601** | **15,428** |

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 Comprehensive Income.

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.

In addition to those recognised above, unused tax losses totalling £25.3m (2011: £25.3m) have not been recognised as the Directors do not consider that it is probable that they will be recovered.

### Deferred tax liabilities

| | Pension scheme £'000 | Acquisition intangibles £'000 | Accelerated capital allowances £'000 | Total £'000 |
|---|---|---|---|---|
| At 1 January 2011 | — | 6,683 | 300 | 6,983 |
| Acquired on acquisition | — | 978 | — | 978 |
| Credit to Income Statement | — | (2,664) | — | (2,664) |
| At 1 January 2012 | — | 4,997 | 300 | 5,297 |
| Acquired on acquisition | 3,259 | 4,765 | — | 8,024 |
| Credit to Income Statement | (27) | (1,499) | (300) | (1,826) |
| Credit to Consolidated Statement of Comprehensive Income | (7) | — | — | (7) |
| **At 31 December 2012** | **3,225** | **8,263** | **—** | **11,488** |

Intangible assets acquired as part of a business combination are capitalised at fair value at the date of the acquisition and amortised over their useful economic lives. The UK tax regime calculates tax using the individual financial statements of the members of the Group and not the consolidated accounts. Hence, the tax base of acquisition intangible assets is £nil. The estimated tax effect of this £nil tax base is accounted for as a deferred tax liability which is released over the period of amortisation of the associated acquisition intangible asset.

## 23. Share capital and reserves

### Classes of reserves

Called up share capital represents the nominal value of shares that have been issued.

Share premium represents the difference between the nominal value of shares issued and the total consideration received.

Share-based payment reserve represents employee remuneration which is credited to the share-based payment reserve until the related share options are exercised. Upon exercise the share-based payment reserve is transferred to retained earnings.

The merger reserve relates to the difference between the nominal value and total consideration in respect of acquisitions, where the Company was entitled to the merger relief offered by the Companies Act.

### Share capital

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Allotted, called up and fully paid | | |
| At 1 January 85,658,763 (2011: 84,815,470) ordinary shares of 1p each | **857** | 848 |
| Issue of 2,833,489 (2011: nil) shares on acquisition of Morrison Facilities Services Limited | **28** | — |
| Issue of 3,367,659 (2011: 843,293) shares on exercise of share options | **34** | 9 |
| At 31 December 91,859,911 (2011: 85,658,763) ordinary shares of 1p each | **919** | 857 |

During the year, 3,367,659 (2011: 843,293) ordinary 1p shares were issued in respect of share options exercised. The difference between the nominal value of £0.03m and the total consideration of £1.4m has been credited to the share premium account.

During the year, 2,833,489 ordinary 1p shares were issued in respect of the acquisition of Morrison Facilities Services Limited, with the difference between the nominal value of £0.03m and the total consideration of £8.0m being credited to the merger reserve.

The fair value of the liabilities acquired in respect of the acquisition of Morrison Facilities Services Limited is currently considered to be provisional awaiting further information in respect of certain liabilities. The fair value included above is the Directors' best estimate of liabilities acquired.

## 24. Notes to the Consolidated Cash Flow Statement

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

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Depreciation | **3,694** | 3,238 |
| Cost of acquisitions | **829** | 79 |
| Loss/(profit) on disposal of property, plant and equipment | **16** | (24) |
| Amortisation | **8,913** | 8,404 |
| Share-based payments | **250** | 200 |
| IAS 19 pension movement | **(4,028)** | (1,007) |
| Finance income | **(11)** | — |
| Finance cost | **2,773** | 2,429 |
| Total | **12,436** | 13,319 |

## 25. Acquisitions

On 7 November 2012 the Group acquired the entire issued share capital of Morrison Facilities Services Limited for a total consideration of £24.1m which was satisfied by £16.1m in cash and the issue of 2,833,489 ordinary 1p shares. The fair value of shares issued was determined using the closing price on the acquisition date of 282.3p. The effect of the acquisition on the Group's assets was as follows:

| | Book and provisional fair value | | |
|---|---|---|---|
| | Morrison Facilities Services Limited £'000 | Other £'000 | Total £'000 |
| **Assets** | | | |
| **Non-current** | | | |
| Property, plant and equipment | 3,172 | — | 3,172 |
| Pension and other employee benefits | 14,171 | — | 14,171 |
| Deferred tax asset | 9,782 | — | 9,782 |
| **Current** | | | |
| Inventories | 1,380 | — | 1,380 |
| Trade receivables | 36,316 | — | 36,316 |
| Current tax asset | 317 | — | 317 |
| Other receivables | 2,373 | — | 2,373 |
| **Total assets** | 67,511 | — | 67,511 |
| **Liabilities** | | | |
| **Non-current** | | | |
| Pension and other employee benefits | (1,794) | — | (1,794) |
| Deferred tax liabilities | (3,259) | — | (3,259) |
| **Current** | | | |
| Short-term borrowings and overdrafts | (3,434) | — | (3,434) |
| Trade and other payables | (73,602) | (100) | (73,702) |
| **Total liabilities** | (82,089) | (100) | (82,189) |
| Net assets acquired | (14,578) | (100) | (14,678) |
| Intangibles capitalised | 20,255 | 460 | 20,715 |
| Deferred tax liability recognised in respect of intangibles capitalised | (4,659) | (106) | (4,765) |
| Goodwill capitalised | 23,102 | 106 | 23,208 |
| | 24,120 | 360 | 24,480 |
| Satisfied by: | | | |
| – cash | 16,120 | 360 | 16,480 |
| – shares issued | 8,000 | — | 8,000 |
| | 24,120 | 360 | 24,480 |

## 25. Acquisitions continued

The Morrison Facilities Services Limited intangible asset is recognised and valued at £20.3m. This represents the expected value to be derived from the acquired customer related contracts and associated relationships. The value placed on these customer relationships is based on the expected cash inflows over the estimated remaining life or each contract. The cash flows are discounted using a rate of 14.1% which the Directors consider is commensurate with the risks associated with capturing returns from the customer relationships. The estimated life is assumed to be the average remaining period of the contracts over which earnings from the customer relationships are expected to be generated. This is an average of five years for contracts relating to social housing and 20 years for contracts relating to facilities management.

The Directors consider that the value assigned to goodwill represents the workforce acquired and the access to additional geographical areas in the UK as a result of this acquisition.

In the period ended 31 December 2012, the Morrison Facilities Services Limited acquisition contributed revenue of £45.0m and a £5.1m operating loss before amortisation of acquisition intangibles.

For the year ended 31 December 2012, had the acquisition taken place on 1 January 2012, the combined Group full-year revenue for the year is estimated at £279.6m and the combined Group loss for the year before taxation is estimated at £37.0m.

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

| | Total £'000 |
|---|---|
| Cash consideration | (16,360) |
| Stamp duty paid | (120) |
| Costs paid | (830) |
| Short-term borrowings and overdrafts | (3,434) |
| Cash refunded in respect of prior year acquisitions | 223 |
| | (20,521) |

During the year the Group received £0.2m in respect of a refund of consideration paid relating to acquisitions in prior periods which has been accounted for as a measurement period adjustment and has reduced the value of goodwill capitalised.

## 26. 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 £1.6m (2011: £1.7m) to these schemes.

### Defined benefit schemes

The Group contributes to 30 (2011: 15) principal defined benefit schemes on behalf of a number of employees which require contributions to be made to separately administered funds.

These pension schemes are operated on behalf of Mears Limited, Scion Group Limited, Mears Care Limited, Morrison Facilities Services Limited and their subsidiary undertakings. The assets of the scheme are administered by trustees in funds independent from the assets of the Group.

In certain cases, the Group will participate under Admitted Body status in the Local Government Pension Scheme. The Group will contribute for a finite period up until the end of the particular contract. The Group is required to pay regular contributions as detailed in the scheme's schedule of contributions. In some cases these contributions are capped and any excess can be recovered from the body from which the employees originally transferred. Where the Pension Scheme has a contractual right to recover the costs of making good any deficit in the scheme from the Group's client, the fair value of that asset has been recognised within the Group's share of the scheme assets and disclosed on page 89. Certain judgements around the value of this asset have been made and are discussed in the judgements and estimates disclosure within the accounting policies.

Following the transfer of a number of employees in respect of new contracts in the year, the Group has gained Admitted Body status for four additional defined benefit schemes. At the time of admission these schemes had a net surplus of £13.4m. The initial plan assets and liabilities recognised as a result of these admissions are shown as 'Contract transfers' on pages 90 and 91.

## 26. Pensions continued

### Defined benefit schemes continued

On the acquisition of Morrison Facilities Services Limited, the Group acquired Admitted Body status for ten additional defined benefit schemes and acquired one additional Group defined benefit scheme. The initial plan assets and liabilities recognised as a result of this acquisition are shown as 'Acquisitions' on pages 90 and 91.

The disclosures in respect of the two (2011: one) Group defined benefit schemes and the 28 (2011: 14) other defined benefit schemes in this note have been aggregated.

### IAS 19 'Employee Benefits'

Costs and liabilities of the scheme are based on actuarial valuations. The latest full actuarial valuations for the schemes were updated to 31 December 2012 by qualified independent actuaries using the projected unit method.

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

| | 2012 | 2011 |
|---|---|---|
| Rate of increase of salaries – long term | **2.85%** | 3.0% |
| Rate of increase for pensions in payment | **2.5%** | 2.6% |
| Discount rate | **4.7%** | 4.9% |
| Retail Price Inflation | **2.85%** | 3.0% |
| Consumer Price Inflation | **2.15%** | 2.0% |
| Life expectancy for a 65 year old male | **21.4 years** | 21.4 years |
| Life expectancy for a 65 year old female | **23.8 years** | 23.6 years |

Expected rates of return on investments are:

| | 2012 % | 2011 % |
|---|---|---|
| Equities | **7.50** | 7.75 |
| Bonds | **4.70** | 4.70 |
| Property | **6.75** | 7.25 |
| Cash | **2.85** | 3.20 |

The amounts recognised in the Balance Sheet and major categories of plan assets are:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Equities | **38,576** | **184,571** | **223,147** | 6,279 | 47,169 | 53,448 |
| Bonds | **44,390** | **64,898** | **109,288** | 1,661 | 17,996 | 19,657 |
| Guarantee | **—** | **3,172** | **3,172** | — | 126 | 126 |
| Property | **1,136** | **20,319** | **21,455** | 16 | 7,274 | 7,290 |
| Cash | **5,635** | **13,368** | **19,003** | 349 | 1,745 | 2,094 |
| Group's estimated asset share | **89,737** | **286,328** | **376,065** | 8,305 | 74,310 | 82,615 |
| Present value of funded scheme liabilities | **(79,336)** | **(260,689)** | **(340,025)** | (13,097) | (68,828) | (81,925) |
| Funded status | **10,401** | **25,639** | **36,040** | (4,792) | 5,482 | 690 |
| Scheme surpluses not recognised as assets | **—** | **(27,758)** | **(27,758)** | — | (6,530) | (6,530) |
| Pension asset/(liability) | **10,401** | **(2,119)** | **8,282** | (4,792) | (1,048) | (5,840) |

## 26. Pensions continued

**IAS 19 'Employee Benefits'** continued

The amounts recognised in the Income Statement are as follows:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Other Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Current service cost | **563** | **3,397** | **3,960** | 218 | 2,447 | 2,665 |
| Past service cost | **—** | **—** | **—** | — | — | — |
| Total operating charge | **563** | **3,397** | **3,960** | 218 | 2,447 | 2,665 |
| Amount charged to net interest payable: | | | | | | |
| – expected return on pension scheme assets | **(1,117)** | **(8,891)** | **(10,008)** | (531) | (4,674) | (5,205) |
| – interest on obligations | **1,259** | **5,777** | **7,036** | 675 | 4,251 | 4,926 |
| | **142** | **(3,114)** | **(2,972)** | 144 | (423) | (279) |
| Total charged to the result for year | **705** | **283** | **988** | 362 | 2,024 | 2,386 |

Cumulative actuarial gains and losses recognised in equity are as follows:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| At 1 January | **(1,380)** | **(6,433)** | **(7,813)** | (1,317) | (7,342) | (8,659) |
| On TUPE transfer of employees | **—** | **13,447** | **13,447** | — | (540) | (541) |
| Actuarial gain/(loss) recognised in the year | **172** | **(784)** | **(612)** | (63) | 7,434 | 7,372 |
| | **(1,208)** | **6,230** | **5,022** | (1,380) | (448) | (1,828) |
| Reduction in actuarial gain/(loss) due to non-recognition of scheme surpluses | **—** | **(15,118)** | **(15,118)** | — | (5,985) | (5,985) |
| Total at 31 December | **(1,208)** | **(8,888)** | **(10,096)** | (1,380) | (6,433) | (7,813) |

Changes in the present value of the defined benefit obligations are as follows:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Other Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Present value of obligations at 1 January | **13,098** | **68,827** | **81,925** | 13,112 | 77,725 | 90,837 |
| Current service cost | **563** | **3,397** | **3,960** | 218 | 2,447 | 2,665 |
| Past service cost | **—** | **—** | **—** | — | — | — |
| Interest on obligations | **1,259** | **5,777** | **7,036** | 675 | 4,251 | 4,926 |
| Plan participants' contributions | **159** | **1,261** | **1,420** | 69 | 796 | 865 |
| Benefits paid | **(895)** | **(2,308)** | **(3,203)** | (329) | (1,145) | (1,474) |
| Contract transfer | **—** | **32,474** | **32,474** | — | 3,948 | 3,948 |
| Acquisitions | **64,810** | **149,441** | **214,251** | — | — | — |
| Actuarial loss/(gain) | **342** | **1,820** | **2,162** | (648) | (19,194) | (19,842) |
| Present value of obligations at 31 December | **79,336** | **260,689** | **340,025** | 13,097 | 68,828 | 81,925 |

## 26. Pensions continued

### IAS 19 'Employee Benefits' continued

Changes in the fair value of the plan assets are as follows:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | **Other Group schemes £'000** | **Other schemes £'000** | **Total £'000** | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Fair value of plan assets at 1 January | **8,305** | **74,310** | **82,615** | 7,694 | 75,995 | 83,689 |
| Expected return on plan assets | **1,117** | **8,891** | **10,008** | 531 | 4,674 | 5,205 |
| Employers' contributions | **1,556** | **3,460** | **5,016** | 1,051 | 2,342 | 3,393 |
| Plan participants' contributions | **159** | **1,261** | **1,420** | 69 | 796 | 865 |
| Benefits paid | **(895)** | **(2,308)** | **(3,203)** | (329) | (1,145) | (1,474) |
| Contract transfer | **—** | **45,921** | **45,921** | — | 3,407 | 3,407 |
| Acquisitions | **78,981** | **153,757** | **232,738** | — | — | — |
| Actuarial gain/(loss) | **514** | **1,036** | **1,550** | (711) | (11,759) | (12,470) |
| Fair value of plan assets at 31 December | **89,737** | **286,328** | **376,065** | 8,305 | 74,310 | 82,615 |

History of experience gains and losses are as follows:

| | Group schemes | | | | |
|---|---|---|---|---|---|
| | **2012 £'000** | 2011 £'000 | 2010 £'000 | 2009 £'000 | 2008 £'000 |
| Fair value of scheme assets | **89,737** | 8,305 | 7,694 | 2,220 | 1,783 |
| Net present value of defined benefit obligations | **(79,336)** | (13,097) | (13,112) | (2,521) | (2,231) |
| Net surplus/(deficit) | **10,401** | (4,792) | (5,418) | (321) | (448) |
| Experience adjustments arising on scheme assets | | | | | |
| Amount | **514** | (711) | (20) | 186 | (411) |
| Percentage of scheme assets | **0.6%** | (8.6%) | (0.3%) | 8.4% | (23.1%) |
| Experience adjustments arising on scheme liabilities | | | | | |
| Amount | **—** | (21) | (21) | (79) | — |
| Percentage of scheme assets | **—** | (0.2%) | (0.2%) | (3.1%) | — |

## 26. Pensions continued

### IAS 19 'Employee Benefits' continued

| | Other schemes | | | | |
|---|---|---|---|---|---|
| | **2012 £'000** | 2011 £'000 | 2010 £'000 | 2009 £'000 | 2008 £'000 |
| Fair value of scheme assets | **286,328** | 74,310 | 75,995 | 62,005 | 43,792 |
| Net present value of defined benefit obligations | **(260,689)** | (68,828) | (77,725) | (64,485) | (40,547) |
| Net surplus/(deficit) | **25,639** | 5,482 | (1,730) | (2,460) | (2,349) |
| Asset value not recognised as surplus | **(27,758)** | (6,530) | (545) | (424) | (3,285) |
| Net deficit | **(2,119)** | (1,048) | (2,575) | (2,884) | (5,634) |
| Experience adjustments arising on scheme assets | | | | | |
| Amount | **1,036** | (11,759) | 3,521 | 9,561 | (8,116) |
| Percentage of scheme assets | **0.4%** | (15.8%) | 4.6% | 15.4% | 18.5% |
| Experience adjustments arising on scheme liabilities | | | | | |
| Amount | **3** | 8,521 | 397 | 1,443 | 4 |
| Percentage of scheme assets | **—** | 12.4% | 0.5% | 2.2% | — |

The employers' contributions expected to be paid during the financial year ending 31 December 2013 amount to £9.4m.

## 27. Operating lease commitments

Non-cancellable operating lease rentals payable were as follows:

| | Land and buildings | | Other | |
|---|---|---|---|---|
| | **2012 £'000** | 2011 £'000 | **2012 £'000** | 2011 £'000 |
| Payable | | | | |
| Within one year | **3,270** | 2,543 | **15,029** | 9,842 |
| Between two and five years | **7,885** | 6,556 | **23,726** | 14,798 |
| After more than five years | **2,982** | 2,948 | **—** | — |

Operating lease payments represent rentals payable by the Group for certain of its office properties, the hire of vehicles and the hire of other equipment. These leases have durations ranging from three to 15 years. No arrangements have been entered into in respect of contingent rental payments.

## 28. Capital commitments

The Group had no capital commitments at 31 December 2012 or at 31 December 2011.

## 29. Contingent liabilities

The Group has guaranteed that it will complete certain contracts that it has commenced. At 31 December 2012 these guarantees amounted to £10.8m (2011: £8.6m).

The Group had no other contingent liabilities at 31 December 2012 or at 31 December 2011.

## 30. Related party transactions

### Identity of related parties
The Group has a related party relationship with its pension schemes, its subsidiaries and with its Directors.

### Pension schemes
Details of contributions to pension schemes are set out in note 26 to the financial statements.

### Subsidiaries
The Group has a central treasury arrangement in which all subsidiaries participate. The Directors do not consider it meaningful to set out details of transfers made in respect of this treasury arrangement between companies, nor do they consider it meaningful to set out details of interest or dividend payments made within the Group.

### Transactions with key management personnel
The Group has identified key management personnel as the Directors of Mears Group PLC.

Key management personnel held the following percentage of voting shares in Mears Group PLC:

| | **2012 %** | 2011 % |
|---|---|---|
| Directors | **0.4** | 0.9 |

Key management personnel's compensation is as follows:

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Salaries | **2,025** | 1,560 |
| Contributions to defined contribution pension schemes | **185** | 190 |
| Share-based payments | **50** | 60 |
| | **2,260** | 1,810 |

Further details of Directors' remuneration are disclosed within the Remuneration Report.

### Transactions with other related parties
During the year the Group purchased customer care related services from Asert LLP, a company in which Mears Group PLC is a 50% partner, totalling £0.01m (2011: £0.01m). At 31 December 2012 the Group was owed £0.01m (2011: £0.02m) by Asert LLP. The Group also purchased call centre related services from Mears 24/7 LLP, a company in which Mears Limited is a 50% partner, totalling £2.1m (2011: £0.3m). At 31 December 2012 the Group owed £0.1m (2011: £nil) to Mears 24/7 LLP.

During the year Morrison Scotland LLP purchased goods and services totalling £3.3m from Morrison Scotland Services Limited. At 31 December 2012 Morrison Scotland LLP owed Morrison Scotland Services Limited £5.7m. At 31 December 2012 Morrison Scotland Services Limited owed Morrison Facilities Services Limited £10.9m. During the year Manchester Working Limited purchased goods and services totalling £0.01m from Morrison Facilities Services Limited. At 31 December 2012 Morrison Facilities Services Limited owed Manchester Working Limited £1.8m.

## 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. The following accounting policies have remained unchanged from the previous year.

## Investments

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

## Goodwill

Goodwill representing the reallocation of amounts previously classed as investments upon the hive across of trade and assets is capitalised and amortised on a straight-line basis over its estimated useful economic life.

## Share-based employee remuneration

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

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

Share-based remuneration in respect of employees of the Company is ultimately recognised as an expense in the Income Statement with a corresponding credit to share-based payment reserve.

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

## Deferred taxation

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

## Retirement benefits

**i) Defined contribution pension scheme**
The pension costs charged against profits are the contributions payable to individual policies in respect of the accounting period.

**ii) Defined benefit pensions**
The Company contributes to one defined benefit scheme.

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

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

Actuarial gains and losses are recognised immediately through the Statement of Total Recognised Gains and Losses. The net surplus or deficit is presented with other net assets on the Balance Sheet, net of any related deferred balance. A surplus is recognised only to the extent that it is recoverable by the Company.

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

## Financial instruments

### Financial liabilities

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the entity after deducting all of its financial liabilities.

Where the contractual obligations of financial instruments (including share capital) are equivalent to a similar debt instrument, those financial instruments are classed as financial liabilities. Financial liabilities are presented as such in the Balance Sheet. Finance costs and gains or losses relating to financial liabilities are included in the profit and loss account. Finance costs are calculated so as to produce a constant rate of return on the outstanding liability.

Where the contractual terms of share capital do not have any terms meeting the definition of a financial liability then this is classed as an equity instrument. Dividends and distributions relating to equity instruments are debited direct to equity.

### Trade debtors

Trade debtors are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods or services directly to a debtor with no intention of trading the debtors. Trade debtors are initially recorded at invoiced value (less any provisional estimate for impairment) and subsequently remeasured at invoiced value, less an updated provision for impairment. Any change in their value through impairment or reversal of impairment is recognised in the profit and loss account.

### 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.

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

### Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

The Company uses derivative financial instruments to hedge its exposure to interest rate risks arising from its financing activities. In accordance with its treasury policy the Company does not hold or issue derivative financial instruments for trading purposes. The Company recognises gains or losses on derivatives at fair value through the profit and loss account except where cash flow hedge accounting is applied.

### Hedge accounting for interest rate swaps

Where an interest rate swap is designated as a hedge of the variability in cash flows of an existing or highly probable forecast loan interest payment, the effective part of any valuation gain or loss on the swap instrument is recognised in equity in the hedging reserve. The cumulative gain or loss is removed from equity and recognised in the profit and loss account at the same time as the hedged transaction. The ineffective part of any gain or loss is recognised in the profit and loss account immediately.

When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer probable, the cumulative unrealised gain or loss recognised in equity is recognised in the Income Statement immediately.

| | Note | 2012 £'000 | 2011 £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Intangible assets: goodwill | 5 | **2,907** | 3,876 |
| Investments | 6 | **73,197** | 57,048 |
| | | **76,104** | 60,924 |
| **Current assets** | | | |
| Debtors | 7 | **76,664** | 77,141 |
| Cash at bank and in hand | | **963** | — |
| | | **77,627** | 77,141 |
| **Creditors:** amounts falling due within one year | 8 | **(17,759)** | (7,547) |
| **Net current assets** | | **59,868** | 69,594 |
| **Total assets less current liabilities** | | **135,972** | 130,518 |
| **Creditors:** amounts falling due after more than one year | 9 | **(55,879)** | (55,879) |
| **Provisions for liabilities** | | | |
| Pension liability | 14 | **(2,789)** | (3,594) |
| | | **77,304** | 71,045 |
| **Capital and reserves** | | | |
| Called up share capital | 10 | **919** | 857 |
| Share premium account | 11 | **34,910** | 33,554 |
| Share-based payment reserve | 11 | **1,685** | 2,965 |
| Hedging reserve | 11 | **(1,913)** | (1,259) |
| Profit and loss account | 11 | **41,703** | 34,928 |
| **Equity shareholders' funds** | | **77,304** | 71,045 |

The financial statements were approved by the Board of Directors on 9 April 2013.

**R Holt**
**Director**

**A C M Smith**
**Director**

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

## 1. Profit for the financial year

The Parent Company has taken advantage of Section 408 of the Companies Act 2006 and has not included its own profit and loss account in these financial statements. The Group profit for the year includes a profit of £11.9m (2011: £16.2m) which is dealt with in the financial statements of the Company. This result is stated after charging auditor's remuneration of £64,000 relating to audit services and £5,000 relating to taxation services.

## 2. Directors and employees

**Employee benefits expense**

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

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Wages and salaries | **1,273** | 1,351 |
| Social security costs | **752** | 209 |
| Other pension costs | **185** | 190 |
| | **2,210** | 1,750 |

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

| | **2012 Number** | 2011 Number |
|---|---|---|
| Office and management | **11** | 11 |

Details relating to the remuneration in respect of the highest paid Director are detailed in note 5 of the consolidated financial statements.

## 3. Share-based employee remuneration

As at 31 December 2012 the Group maintained six share-based payment schemes for employee remuneration. The details of each scheme are included within note 6 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 2012 (2011: £0.1m), which gave rise to additional paid-in capital. No liabilities were recognised due to share-based payment transactions.

## 4. Dividends

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

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Final 2011 dividend of 5.35p (2011: final 2010 dividend of 4.85p) per share | **4,698** | 4,123 |
| Interim 2012 dividend of 2.30p (2011: interim 2011 dividend of 2.15p) per share | **2,041** | 1,839 |
| | **6,739** | 5,962 |

The proposed final 2012 dividend of 5.70p per share has not been included within the financial statements as no obligation existed at 31 December 2012.

## 5. Goodwill

| | Goodwill £'000 |
|---|---|
| **Cost** | |
| **At 1 January 2012 and at 31 December 2012** | **6,196** |
| **Amortisation** | |
| At 1 January 2012 | 2,320 |
| Charge for the year | 969 |
| **At 31 December 2012** | **3,289** |
| **Net book value** | |
| **At 31 December 2012** | **2,907** |
| At 31 December 2011 | 3,876 |

## 6. Fixed asset investments

| | Investment in subsidiary undertakings £'000 | Loans £'000 | Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2012 | 35,048 | 22,000 | 57,048 |
| Additions | 16,149 | — | 16,149 |
| **At 31 December 2012** | **51,197** | **22,000** | **73,197** |

Additions to investments in subsidiary undertakings relate to the acquisition of Morrison Facilities Services Limited. The entire share capital of Morrison Facilities Services Limited was acquired on 8 November 2012. Further details are provided in note 25 to the consolidated financial statements.

Details of the principal subsidiary undertakings of the Company are shown in note 14 to the consolidated financial statements.

## 7. Debtors

| | **2012 £'000** | 2011 £'000 |
|---|---|---|
| Amounts owed by Group undertakings | **74,915** | 75,574 |
| Prepayments and accrued income | **1,177** | 1,147 |
| Deferred tax asset | **572** | 420 |
| | **76,664** | 77,141 |

The deferred tax asset above of £0.6m is due after more than one year. The recoverability of the deferred tax asset is dependent on future taxable profits. The Company expects to realise sufficient profits to enable the deferred tax asset to be recovered.

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

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Bank loan | **15,000** | 5,000 |
| Bank overdraft | **—** | 588 |
| Other creditors | **9** | 2 |
| Accruals | **2,750** | 1,957 |
| | **17,759** | 7,547 |

Included within accruals is £2.7m (2011: £2.0m) relating to an interest rate hedge.

## 9. Creditors: amounts falling due in more than one year

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Bank loan | **55,000** | 55,000 |
| Other creditors | **879** | 879 |
| | **55,879** | 55,879 |

The Company has disclosed core bank borrowings of £55m as due in two to five years. Whilst the amounts borrowed could be repaid each quarter, the Company's intention is to align core bank borrowings with its interest rate swaps.

Included in other creditors is £0.9m (2011: £0.9m) relating to deferred consideration on acquisitions.

## 10. Share capital

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Allotted, called up and fully paid | | |
| 85,658,763 (2011: 84,815,470) ordinary shares of 1p each | **857** | 848 |
| Issue of 2,833,489 (2011: nil) shares on acquisition of Morrison Facilities Services Limited | **28** | — |
| Issue of 3,367,659 (2011: 843,293) shares on exercise of share options | **34** | 9 |
| 91,859,911 (2011: 85,658,763) ordinary shares of 1p each | **919** | 857 |

During the year, 3,367,659 (2011: 843,293) ordinary 1p shares were issued in respect of share options exercised. The difference between the nominal value of £0.03m and the total consideration of £1.4m has been credited to the share premium account.

During the year, 2,833,489 ordinary 1p shares were issued in respect of the acquisition of Morrison Facilities Services Limited. The Company took advantage of merger relief in respect of the difference between the nominal value of £0.03m and the total consideration of £8.0m.

## 11. Share premium account and reserves

| | Share capital £'000 | Share premium account £'000 | Share-based payment reserve £'000 | Hedging reserve £'000 | Profit and loss account £'000 |
|---|---|---|---|---|---|
| At 1 January 2012 | 857 | 33,554 | 2,965 | (1,259) | 34,928 |
| Issue of shares | 62 | 1,356 | — | — | — |
| Share option charges | — | — | 250 | — | — |
| Exercise of share options | — | — | (1,530) | — | 1,530 |
| Cash flow hedge | — | — | — | (654) | — |
| Profit for the year | — | — | — | — | 11,942 |
| Equity dividends | — | — | — | — | (6,739) |
| Actuarial gain on defined benefit pension scheme net of deferred tax | — | — | — | — | 42 |
| **At 31 December 2012** | **919** | **34,910** | **1,685** | **(1,913)** | **41,703** |

## 12. Capital commitments

The Company had no capital commitments at 31 December 2012 or at 31 December 2011.

## 13. Contingent liabilities

The Company had no contingent liabilities at 31 December 2012 or at 31 December 2011.

## 14. Pensions

### Defined contribution schemes

The Company contributes to personal pension schemes of the Directors.

### Defined benefit scheme

The Company operates a defined benefit pension scheme for the benefit of certain employees of its subsidiary companies. The assets of the schemes are administered by trustees in a fund independent from the assets of the Company.

Costs and liabilities of the scheme are based on actuarial valuations. The actuarial valuations were reviewed and updated to 31 December 2012 by a qualified independent actuary using the projected unit method.

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

| | **2012** | 2011 |
|---|---|---|
| Rate of increase of salaries | **2.85%** | 3.0% |
| Rate of increase for pensions in payment | **2.5%** | 2.6% |
| Discount rate | **4.7%** | 4.9% |
| Retail price inflation | **2.85%** | 3.0% |
| Life expectancy for a 65 year old male | **22.5 years** | 22.4 years |
| Life expectancy for a 65 year old female | **24.0 years** | 23.9 years |

Expected rates of return on investments are:

| | **2012 %** | 2011 % |
|---|---|---|
| Equities | **7.50** | 7.75 |
| Bonds | **4.70** | 4.70 |
| Property | **6.75** | 7.25 |
| Cash | **2.85** | 3.20 |

## 14. Pensions continued

**Defined benefit scheme** continued

The amounts recognised in the Balance Sheet and major categories of plan assets as a percentage of total plan assets are:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Equities | **7,953** | 6,279 |
| Bonds | **1,835** | 1,661 |
| Property | **102** | 17 |
| Cash | **306** | 348 |
| Group's estimated asset share | **10,196** | 8,305 |
| Present value of funded scheme liabilities | **(13,818)** | (13,097) |
| Funded status | **(3,622)** | (4,792) |
| Related deferred tax asset | **833** | 1,198 |
| Pension liability | **(2,789)** | (3,594) |

The amounts recognised in the profit and loss account are as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Current service cost | **195** | 109 |
| Past service cost | **—** | — |
| Total operating charge | **195** | 109 |
| Amount charged to net interest payable: | | |
| – expected return on pension scheme assets | **(607)** | (454) |
| – interest on obligations | **636** | 609 |
| | **29** | 155 |
| Total charged to the result for year | **224** | 264 |

Changes in the present value of the defined benefit obligations are as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Present value of obligations at 1 January | **13,097** | — |
| Current service cost | **195** | 109 |
| Past service cost | **—** | — |
| Interest on obligations | **636** | 609 |
| Plan participants' contributions | **76** | 35 |
| Benefits paid | **(498)** | (315) |
| Change of principal employer | **—** | 10,591 |
| Transfer in | **—** | 2,525 |
| Actuarial gain/(loss) | **312** | (457) |
| Present value of obligations at 31 December | **13,818** | 13,097 |

## 14. Pensions continued

**Defined benefit scheme** continued

Changes in the fair value of the plan assets are as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Fair value of plan assets at 1 January | **8,305** | — |
| Expected return on plan assets | **607** | 454 |
| Employers' contributions | **1,192** | 884 |
| Plan participants' contributions | **76** | 35 |
| Benefits paid | **(498)** | (315) |
| Change of principal employer | **—** | 5,494 |
| Transfer in | **—** | 2,384 |
| Actuarial gain/(loss) | **514** | (631) |
| Fair value of plan assets at 31 December | **10,196** | 8,305 |

The movements in the net pension liability and the amount recognised in the Balance Sheet are as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| Deficit in schemes at 1 January | **(4,792)** | — |
| Current service cost | **(195)** | (109) |
| Past service cost | **—** | — |
| Contributions | **1,192** | 884 |
| Other finance income | **(29)** | (155) |
| Actuarial loss | **202** | (174) |
| Change of principal employer | **—** | (5,097) |
| Transfer in | **—** | (141) |
| Deficit in schemes at 31 December | **(3,622)** | (4,792) |

Cumulative actuarial gains and losses recognised in equity are as follows:

| | 2012 £'000 | 2011 £'000 |
|---|---|---|
| At 1 January | **(5,412)** | — |
| Change of principal employer | **—** | (5,097) |
| Transfer in | **—** | (141) |
| Actuarial loss recognised in the year | **202** | (174) |
| Total at 31 December | **(5,210)** | (5,412) |

## 14. Pensions continued

**Defined benefit scheme** continued

History of experience gains and losses are as follows:

| | **2012 £'000** | 2011 £'000 | 2010 £'000 | 2009 £'000 |
|---|---|---|---|---|
| Fair value of scheme assets | **10,196** | 8,305 | — | — |
| Net present value of defined benefit obligations | **(13,818)** | (13,097) | — | — |
| Net deficit | **(3,622)** | (4,792) | — | — |
| Experience adjustments arising on scheme assets | | | | |
| Amount | **514** | (631) | — | — |
| Percentage of scheme assets | **5.0%** | (4.8%) | — | — |
| Experience adjustments arising on scheme liabilities | | | | |
| Amount | **—** | — | — | — |
| Percentage of scheme assets | **—** | — | — | — |

The employer's contributions expected to be paid during the financial year ending 31 December 2013 amount to £1.2m.

## 15. Related party transactions

The Company has taken advantage of the exemption with FRS 8 not to disclose transactions with companies which are 100% owned by the Group.

During the year one of the Company's subsidiaries, Mears Limited, purchased customer care related services from Asert LLP, a company in which Mears Group PLC is a 50% partner, totalling £0.01m (2011: £0.01m). At 31 December 2012 Mears Limited was owed £0.01m (2011: £0.02m) by Asert LLP. Mears Limited also purchased call centre related services from Mears 24/7 LLP, a company in which Mears Limited is a 50% partner, totalling £2.1m (2011: £0.3m). At 31 December 2012 Mears Limited owed £0.1m (2011: £nil) to Mears 24/7 LLP.

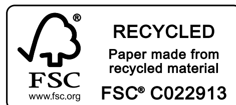
During the year Morrison Scotland LLP purchased goods and services totalling £3.3m from Morrison Scotland Services Limited. At 31 December 2012 Morrison Scotland LLP owed Morrison Scotland Services Limited £5.7m. At 31 December 2012 Morrison Scotland Services Limited owed Morrison Facilities Services Limited £10.9m. During the year Manchester Working Limited purchased goods and services totalling £0.01m from Morrison Facilities Services Limited. At 31 December 2012 Morrison Facilities Services Limited owed Manchester Working Limited £1.8m.

## Income statement

| | 2012 £'000 | 2011 £'000 | 2010 £'000 | 2009 £'000 | 2008 £'000 |
|---|---|---|---|---|---|
| Revenue by business segment | | | | | |
| Social Housing | **504,686** | 415,000 | 379,400 | 355,260 | 282,046 |
| Care | **112,550** | 108,518 | 100,358 | 60,050 | 54,611 |
| Other Services | **62,289** | 65,453 | 44,177 | 54,836 | 83,719 |
| Total sales revenue | **679,525** | 588,971 | 523,935 | 470,146 | 420,376 |
| Gross profit | **183,902** | 174,764 | 150,533 | 133,298 | 110,655 |
| Operating profit before acquisition intangible amortisation and exceptional costs | **31,441** | 33,608 | 31,320 | 24,753 | 21,029 |
| Operating profit | **20,603** | 22,731 | 18,751 | 19,773 | 17,429 |
| Profit for the year before tax | **20,813** | 20,582 | 16,352 | 18,379 | 16,582 |
| Earnings per share | | | | | |
| Basic | **21.89p** | 19.87p | 17.70p | 18.81p | 17.36p |
| Diluted | **21.04p** | 19.03p | 16.57p | 17.94p | 16.82p |
| Dividends per share | **8.00p** | 7.50p | 6.75p | 5.70p | 4.75p |

## Balance sheet

| | 2012 £'000 | 2011 £'000 | 2010 £'000 | 2009 £'000 | 2008 £'000 |
|---|---|---|---|---|---|
| Non-current assets | **211,874** | 149,923 | 146,639 | 89,824 | 76,505 |
| Current assets | **249,719** | 184,207 | 143,669 | 123,793 | 110,140 |
| Current liabilities | **(272,844)** | (169,004) | (133,119) | (98,608) | (87,294) |
| Non-current liabilities | **(19,931)** | (13,341) | (15,635) | (9,081) | (3,647) |
| Total equity | **168,818** | 151,785 | 141,554 | 105,928 | 95,704 |
| Cash and cash equivalents, end of year | **(12,384)** | (13,429) | (12,243) | 6,511 | 6,594 |



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