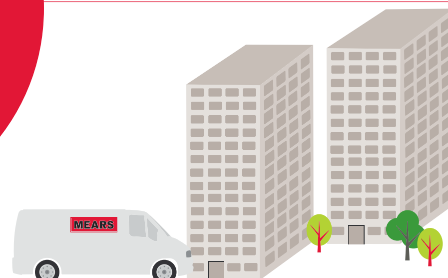
**Mears Group PLC**

Annual report and accounts 2013

# Innovation, leadership and partnership

# 2013: a transformational year




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

**Our vision is to make a positive difference to the communities we serve, through**

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 Care markets.

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

We bring together employers in the areas where we work to meet and provide advice and opportunities to young people and to the long-term unemployed.

Read more about our LEAF events on **page 17**

We have 650 people enrolled in apprenticeship and job experience programmes. Our Mears Brighton branch is an excellent example of our commitment.

Read more about our apprenticeship schemes on **page 15**

Read more about our business model **page 04**

Read more about our strategy on **page 08**

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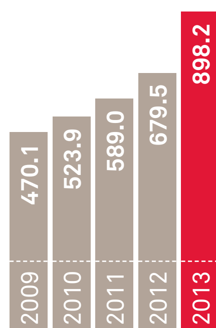
Mears Nurseplus provides more complex services to meet the increasing NHS requirement.

Read more about Mears Nurseplus on **page 28**

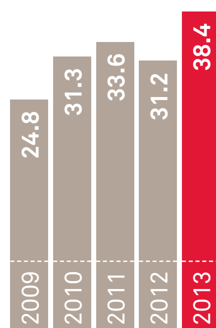
**Group revenue** (£m)

# £898.2m



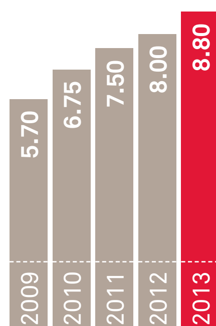

**Group operating profit** (£m)*

# £38.4m



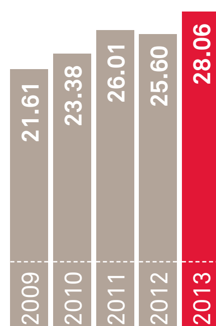

**Dividend per share** (p)

# 8.80p




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

# 28.06p




* Before acquired intangible amortisation and exceptional costs.

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

## Strategic report

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# Mears at a glance

In partnership with our Social Housing customers, we maintain, repair and upgrade the homes of hundreds of thousands of people in communities across the UK. Our Care teams provide support to meet the increasing needs of our elderly population and other vulnerable people living in our communities.

## 1 Our integrated services bring distinct advantages

We are leaders in providing joined up housing and care services to vulnerable people. We look for opportunities for our care staff to work closely with our housing operatives to identify potential hazards that could cause an accident in the home. We call this Care and Repair.

## 2 We work with a range of private and public bodies and associations

We work with Local Authorities, Housing Associations, Community Groups, the NHS and wider Government. We secure long-term contracts with our customers, with Social Housing and Care contracts on average six years and three years in duration respectively.

## Social Housing

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

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

| Revenue | Employee numbers | Office locations |
| --- | --- | --- |
| £742m | c.6,000 | 182 |

**Services include:**

- Repairs
- Planned and cyclical maintenance
- Capital projects
- Fuel poverty initiatives
- Housing management services

**In focus**

Mears and North Lanarkshire Council, a unique JV servicing 37,000 homes.

page 29

**What's next?**

The Social Housing market is expected to continue to develop strongly, driven by a shortage of Social Homes, consolidation of vendors and legislative reforms.

## Care

### We provide personal care to over 20,000 elderly and disabled people.

We provide high quality and flexible care for older and disabled people who want to continue living in their own homes. The majority of our Care contracts are with Local Authorities, who see Care at home as being far more cost effective than residential care.

| Revenue | Employee numbers | Office locations |
| --- | --- | --- |
| £123m | c.9,250 | 117 |

**Services include:**

- Independent living service
- Complex care
- Aids and adaptations
- Assistive technology (telecare)

**In focus**

In Wiltshire, a new commissioning model is transforming the sector.

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**What's next?**

The Care market is expected to show long-term growth driven by the ageing population; a shift in the commissioning practices; Local Authorities and NHS integrating services; and other legislative drivers.

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## We pride ourselves on a market-leading performance

For Mears, leadership means delivering the best service, through highly trained staff, working in close partnership with our clients. This brings long-term sustainable positive financial results.

### Our business model page 04

Our business puts our customer front and centre. Our model is based on our values of innovation and partnership. We lead where we operate.

### Our people page 14

Our best in class service is a direct result of the quality of our people. We recognise our staff as our biggest asset.

### Our strategy page 08

The success of Mears is intrinsically linked to maintaining quality service delivery in both our markets.

### IT systems

Mears' performance is built on a bedrock of first class, in-house IT systems.

4

## Monitoring our success with robust surveys and metrics

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

### Our service delivery leads the market

page 20

We conduct thousands of customer surveys each year and are not satisfied until the feedback is excellent for every job that we do. Where we get complaints, we learn from them and use them as an opportunity to improve our service further.

### Our strong financial performance is as a result of our differentiated strategy

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Our financial KPIs include revenue growth, operating margin and cash conversion.

#### How we performed in 2013

- Social Housing revenues increased by 47%, including organic growth of 10%.
- Care revenues increased by 9%, underpinned by the acquisition of ILS.
- Conversion of EBITDA to cash was 103%.
- The acquisition of ILS increased our capabilities in higher acuity care.
- The speed of the turn around and integration of Morrison exceeded management expectations.
- The disposal of our non-core Mechanical & Electrical business removed a financial challenge for the Group.

# Our business model

Our business model is based on our values of innovation, partnership and leadership.

**Our customers are at the centre of our business.** We feel a strong sense of responsibility towards our customers. We work hard finding ways to improve the long-term prospects of the communities we serve by improving their homes, their neighbourhoods and their lives.

## Our assets

### People

82% of people regard our service as excellent. The major factor behind this success is our commitment to the training and development of our staff. We recognise our staff as our greatest asset and that is why Mears' employees are amongst the most skilled in their relevant job area.

### IT systems

Mears' performance is built on a bedrock of a first class, in-house IT platform giving market-leading capability.

### Supply chain partnerships

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

## Service innovation and market development

### Delivering service improvements

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

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## Contracts

### Contract bidding

We have always been careful to bid for those new contracts that match our values and skills, whilst at the same time recognising the importance of retaining and developing our existing contracts.

### Long-term contracts

We develop long-term relationships. At Mears, we listen to our customers and work hard to meet their needs.

### Strong order book

We have secured orders of £3.8 billion and we have a bid pipeline in excess of £3.0 billion.

## Market-leading performance

### High quality service delivery

Service quality remains our key differentiator. Whilst our shareholders will initially look at our financial outputs, it is our service quality which has always underpinned our success.

### Robust financial management

Our processes and systems are developed with a focus upon providing excellent visibility of job and contract profitability. The efficiency with which we manage working capital remains a cornerstone of our business.

Corporate responsibility is a focal point of our business model
Read more on **pages 16 to 19**

## Shareholder return

### Dividend policy

Our ordinary dividend is funded from our free cash flow. The Board aims to increase the dividend in line with earnings. The dividend has increased by 85% over the last five years.

## Retained earnings investment

### Growth

We have grown through a combination of organic growth supplemented through acquisitions. Both utilise working capital.

### Debt funding

The Board has always been conservative with regard to its appetite for debt. The Board will look to utilise some retained earnings to reduce the level of gearing over time.

We have a clear and effective strategy to support our business model
Read more on **pages 08 and 09**

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

# Chairman's statement

We will continue to differentiate ourselves through tenant-centric customer service and proposition innovations developed in partnership with our customers, combined with robust finances.

**Bob Holt** Chairman

## In summary

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

The disposal of our non-core Mechanical & Electrical business removed a challenge for the Group and has allowed the senior team to focus its attentions exclusively upon our two core growth divisions.

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

We will look to build a significant differentiated housing management offering.

We will continue to move further up the acuity chain in care, filling gaps in our capability both organically and through acquisition.

I am delighted at the excellent progress that has been made in 2013. The integration of the Morrison acquisition proceeded better than I could ever have anticipated. The acquisition of ILS increased our capabilities in higher acuity care whilst enhancing the offering in our existing Care business. Finally, the disposal of our non-core Mechanical & Electrical business removed a significant financial challenge for the Group and has allowed the senior team to refocus its attentions upon our two growth divisions.

### Strategy

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 outstanding customer service and proposition innovations developed in partnership with our customers, combined with robust finances.

The acquisition of ILS was in line with Mears' strategic objective for its Care business which is to increase the level of work in higher acuity services. These activities have made strong progress since the acquisition and we will continue to look to extend both the scope of our capabilities and our geographical coverage.

### 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 final dividend of 6.30p per share which, combined with the interim dividend, gives a total dividend for the year of 8.80p (2012: 8.00p), a 10.0% increase. The dividend is payable on 3 July 2014 to shareholders on the register on 13 June 2014. The dividend is covered over three times by the normalised diluted earnings per share.

### Reg Pomphrett

The end of December brought the news of the passing of Reg Pomphrett, the Company Secretary and a former Non-Executive Director of the Group. Reg was instrumental in the growth of the Group and his wisdom and wit will be sorely missed. I had personally worked with Reg for a number of years and am proud to have known him.

Read more on our corporate governance on **pages 36 to 42**

Read more in the operational review on **pages 26 to 31**

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## Corporate governance

The Board continues to set itself high standards of corporate governance. Our Corporate Governance Report on pages 38 to 42 details how we approach governance and the key areas of focus for the Board in 2013 and into the future. This year sees a new style Annual Report with the adoption of the new Strategic Report. The FRC guidance has directed entities to prepare more concise and relevant reports, with a fuller description of the business model and with risks, threats and weaknesses getting increased recognition. Whilst we have always looked to deliver a balanced message, we have followed the latest guidance to refresh the Annual Report.

## Our people

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. During 2013 we have implemented our Corporate Learning and Development Strategy which has promoted a number of key initiatives with a view to investing in management trainees, skills academies and apprenticeship schemes to ensure there is a constant inflow of new talent. We currently have 650 people enrolled in apprenticeship and job experience programmes. We are proud of the many practical and local opportunities we are able to create.

At the senior end of the business we have increased our focus on succession planning and increased our investment in senior management development. During 2013 we commenced a Senior Leadership Programme which has identified a cross section of the Group's brightest talent that we would envisage will play central roles in our future business. Our management teams continue to be recognised as industry leading.

## Management incentive plan

The Mears Remuneration Committee identified the need for a new structure which better reflects the Group's future business strategy and provides a stronger link between reward and corporate performance in order to appropriately retain and motivate the Executive Directors and senior management who are critical to executing the business strategy. The revised incentive structure delivers in my view an appropriate mix of cash and shares dependent on financial and strategic performance and will be subject to both forfeiture and a longer holding period than the previous arrangement. This approach will ensure that strong year-on-year corporate performance is rewarded. The primary focus on annual performance will also ensure that the Committee retains the flexibility to select targets which drive shareholder value in a highly uncertain and challenging economic and business environment.

## Positive outlook

We expect our Social Housing business to continue to grow through further contract wins, underpinned by our market-leading service delivery. We will look to build a significant housing management offering to our prime market in Social Housing, making Mears even more relevant to customers and tenants. Where appropriate, we will continue to increase our geographical coverage.

In our Care business, we will continue to move further up the acuity chain. The acquisition of the higher acuity activities of ILS will allow us to follow an organic growth strategy. We will also look to small bolt-on acquisitions to fill gaps in our capability. This will increase our ability to respond to growing opportunities from health and Social Care outsourcing and the implementation of new localised services.

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

**R Holt**
**Chairman**
bob.holt@mearsgroup.co.uk
28 March 2014

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# Our strategic goals

Our mission is to be market leader in transforming Social Housing and Care environments, improving homes, improving neighbourhoods and improving lives.

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

## Our values

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

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

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

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

Read more about our case studies in the operational review on **pages 26 to 31**

Read more about our key performance indicators on **pages 20 and 21**

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

## Quality leadership

Strategic priority

### Maintaining quality leadership in both our markets.

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

Achievements and goals

**2013 achievements**

- 82% of our customers rated our services as excellent
- Achieved rapid turnaround of service performance in new Morrison branches
- Secured the first transformational care contract win in Wiltshire
- Accredited for the Government Customer Service Excellence standard and by the Tenant Participation Advisory Service for the quality of our tenant engagement
- RoSPA Gold Award winner for the eleventh consecutive year

**Our 2014 goals**

- To increase our customer satisfaction for tenants rating our service as excellent
- Use the Wiltshire contract as a springboard to winning further output-based Care contracts which reward providers on meeting desired outcomes that have been agreed directly with service users
- To exceed regulatory expectations within Care as defined by the Care Quality Commission
- To maintain high levels of contract retention

KPIs

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

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## A customer-centric model

### Our first thought will always be the needs of our customers.

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

#### 2013 achievements

- Substantially grew our complex care services through the acquisition of ILS
- Was recognised as one of the top 100 employers of apprentices in the UK by the National Apprenticeship Service
- The development of Mears Energy has reduced the fuel bills of thousands of tenants
- Record low levels of accidents
- Record high level of waste recycling

#### Our 2014 goals

- To extend our complex care service across the UK
- To demonstrate the benefits of output-based Care contracts which reward providers on meeting desired outcomes rather than the traditional 'task and time' contracts which give little consideration to the desires of the customer
- To continue to build a network of residents across the country to ensure best practice is transferred to the benefit of all
- To further develop our leading approach to serving our communities
- Expand our housing management services, working in partnership with clients

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

## Market-leading performance

### A robust and sustainable 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.

#### 2013 achievements

- The successful integration of both Morrison and ILS into the Mears Group
- The disposal of the non-core M&E business
- Revenue growth from continuing activities of 40%
- Profit to cash conversion of 103%

#### Our 2014 goals

- To reinforce our market-leading position
- To maintain our long-standing delivery on margin and cash
- To continue the development of Mears' Care IT system

Revenue growth
Operating margins
Profit to cash conversion
Normalised diluted earnings per share
Order book growth

# Our markets

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.

## The Social Housing market

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

### Change drivers

#### Demographic factors

» **The demand for Social Housing continues to exceed supply**
The demand for Social Housing continues to exceed supply, which is driving the development of new affordable homes both for social and market rent.

» **Ageing population**
The ageing population is putting pressure on the need for more homes.

#### Supply side

» **Consolidation of vendors**
We continue to see a consolidation of vendors, as a flight to quality puts pressures on poorly performing providers.

#### Economic

» **Reform of Housing Revenue Account**
The reform of the Housing Revenue Account (HRA) and long-term security around rental increases has increased the availability of finance to fund both refurbishment and development programmes.

» **Pressures of rising fuel poverty**
The pressures of rising fuel poverty have provided additional funding to enable homes to be made more energy efficient.

» **Changes to Welfare Reform**
The changes to the Welfare Reform provide new opportunities to broaden our service into housing management partnership models.

Read more in the operational review on **pages 26 to 31**

Read more in key performance indicators on **pages 20 and 21**

### Funding sources

The total revenue spending resources for Social Housing in England will have increased from £21 billion in 2010 to an estimated £28 billion by 2017. A combination of prudent management, income increases above inflation and increasing investment facilities will support the industry's further growth and development. The latter resource is estimated to be up to £12 billion a year, covering investment in new housing and existing assets. Similar patterns, on a proportionate scale, are expected in Scotland and Wales.

English Social Housing expenditure has increased by 5% in the period 2010 to 2012, with this turnover expected to increase a further 28% over the period from 2013 to 2017. Similar patterns are expected in Scotland and Wales.

This increase in income comes from four sources:

1) Although varying across the sector, generally 80% of funding for repairs and maintenance expenditure comes from collected rent. The basis for annual rent increases from April 2015 will change to CPI plus 1%. The other funding sources are capital receipts from sales, service charges and capital finance.

2) Most Housing Associations build new housing, mainly with a grant contribution from the Government, which increases stock volume and turnover. The arrangements for grant funding have changed in the past three years and there are further amendments to these arrangements now planned for the period 2015 to 2018.

3) Over the period 2010 to 2015, the total number of homes owned and managed by Social Housing providers is expected to increase by approximately 100,000.

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

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## Housing management

### 1. Strong secular drivers of demand

**Change drivers**
Welfare reform
Financial incentives
Housing waiting list
Private rental demands
House building

### 2. Significant market opportunity

**Housing management**

### 3. Differentiated positioning

**Mears strategy**
Preferred partner with existing customers
Superior service delivery ethos
Strong capability synergy
Wide array of potential acquisitions

## Our future growth

### Bid pipeline

The pipeline of repairs and maintenance opportunities will continue to remain strong given the increasing financial strength of many Social Landlords.

### New partnership models

The emergence of new partnering models to the traditional outsourcing contract presents new opportunities for Landlords to work with Mears and thereby enable us to access work that would previously have been done exclusively in-house. Examples of this include Manchester Working, which is a joint venture between Mears and Northwards Housing, as well as our partnership with United Welsh, where Mears manages its wholly owned repairs and maintenance subsidiary, Celtic Horizons.

### Fuel poverty

The Energy Company Obligation (ECO) scheme is providing new funding into Social Housing and Mears Energy has already undertaken work here, helping clients to both access the funding and deliver the works.

### Housing management

The impact of welfare reform and the need to provide more Social Homes is making many clients reconsider best value approaches to housing management. Housing management is a £4 billion opportunity that is almost entirely insourced. Through the development of our Mears 24/7 call centre, and the recent acquisition of Plexus, we are at the outset of broadening our capability to support these new requirements. We have also brought in new senior management, who are recognised as experts in these emerging fields.

**Total number of Social Homes**

**5 million**

# **Our markets** continued

## The Care market

The Care market is expected to show **long-term sustainable growth** linked to a number of change drivers.

### Change drivers

#### Demographic factors

» **Number of people aged over 65 will grow**
The number of people aged over 65 is expected to grow by over six million between 2012 and 2036.

#### Supply side

» **Consolidation and shift in commissioning practices**
Increasing regulatory pressure and demands to increase quality continue to drive consolidation and a shift in commissioning practices to providers who can drive long-term quality improvements.

#### Economic

» **Local Authorities and NHS integrating services**
The drive to reduce pressures on NHS funding has now made it a statutory requirement for Local Authorities to work with the NHS around integrating services. The Spending Review set aside £3.8 billion for service integration on community-based work.

» **Increasing amount of complex care**
An increasing amount of more complex care, often from the NHS, is being commissioned. The main areas are around hospital discharge and end of life care but this will develop into other services in the future.

» **Cap on the maximum amount a person has to pay for their care in 2016**
The recommendations of the Dilnot Commission, now being embedded in the Care Bill, will see a cap on the maximum amount a person has to pay for their care in 2016. This is likely to result in a significantly increased number of people receiving funding towards their care.

Read more in the operational review on **pages 26 to 31**

Read more in key performance indicators on **pages 20 and 21**

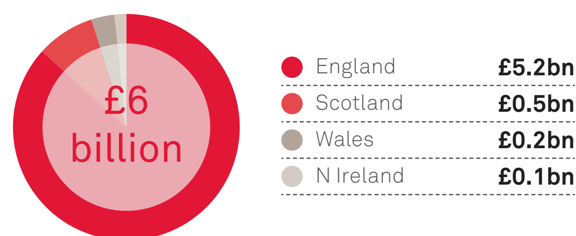
### Funding sources

The main source of funds for care in England, Scotland and Wales are Local Authorities with total spend on Domiciliary Care amounting to £4 billion per year. In addition to this are private individuals that account for an annual spend of a further £1 billion. In addition, the NHS is increasingly involved in directly financing Social Care as the drive for integrated services increases. Local Authorities get the bulk of their funding from Central Government with around a quarter coming from locally raised council tax.

NHS investment in Social Care will increase significantly over the period of the spending review. We expect annual market growth in care spend of in excess of 10% from 2015 to 2017. This will impact, in particular, around more complex community-based services, which can help reduce growing pressures upon NHS facilities.

### Market size

**A £6 billion market size today**



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## Care Commissioning trend

**To...**

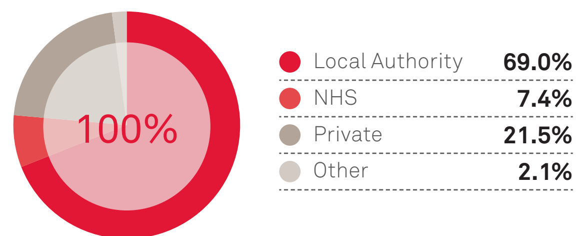
- Paying for tasks done by the minute
- Large frameworks of providers
- Single service tenders
- One to three year tender periods
- Little thought to workforce or broader outcomes
- Care

**From...**

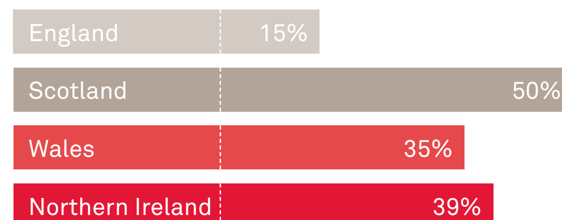
- Commissioning for outcomes
- Strategic partnerships
- Multi-services
- Four to eight year tender periods
- Greater emphasis on workforce development
- Care and nursing-led services

## Funding source

**Current market funding source**




**% further outsourcing potential**




## Our future growth

### Care transformation

We are seeing the emergence of new commissioning models that are much more reflective of the way our Social Housing contracts are commissioned, in that they are long-term partnering orientated, focused on improving quality and cost over time and combining services into an integrated approach. The Wiltshire case study shown on page 30 is truly transformational and is already being replicated by other leading Councils.

### Opportunities in more complex care services

We are seeing increasing opportunities from the NHS around more complex services being delivered in people's homes. More often this is done as a part of an integrated commissioning approach with the Local Authority. Mears Nurseplus, acquired as a part of the ILS transaction in 2013, provides Mears with the opportunity to bid for services where the involvement of nursing staff is required. We have already secured our first community health care work in England and we expect this to be a significant source of growth over the next five years.

# Our people

2013 has focused on the new implementation of our new corporate learning and development (L&D) strategy that was launched in late 2012, as well as the integration of the Mears and Morrison L&D teams and processes.

## Creating opportunities:

**Apprenticeships and work experience**

National Housing Apprenticeship scheme

Job experience programmes

**Management team and development**

Succession planning

Talent development

**Training and development**

Induction

Training centres

Qualifications

In-house training

Training in the community

## Apprenticeships and work experience

In 2013 we launched the Mears National Housing Apprenticeship Scheme, which aims to provide a consistent, quality approach to how we manage apprenticeships, trainees, work experience and work placements. As the centrepiece of our apprenticeship offering, the scheme sets out clearly defined standards and expectations for all those involved in the apprenticeship journey and establishes a defined path for apprentices throughout their term of service.

Heading into 2014, the Group employs 650 apprentices and trainees and is now recognised externally for the quality of this initiative. Mears was named among the top 100 employers by the National Apprenticeship Service at the 2013 National Apprentice Awards, and at the same event had two apprentices invited to meet the Deputy Prime Minister. Mears apprentices have also been recognised at the BEST (Building Engineering Services Training) awards, the APSE (Association for Public Service Excellence) awards and the Lanarkshire Colleges awards. We have also supported a number of apprentice alumni to make the transition to self-employment by providing part-time employment and business enterprise training.

## Management talent and development

During 2013 we identified five levels of management development needs, from entry through to Executive level, and have identified a range of succession planning, talent development and skills-strengthening needs. A pilot programme, targeting those with the potential to become future senior leadership team members, has begun, including representatives from across the Group. We have contract manager and supervisor level programmes ready to launch in early 2014 that focus on enhancing and strengthening of skills in order to improve performance.

The 2013 intake of management trainees is now in place. We were delighted to see an exceptional level of interest and enthusiasm for this opportunity which not only allows fresh talent into the Group but also provides the chance for existing staff to get a foot on the management ladder through a less conventional route.

## Training and development

Our technical training centre was re-launched from our Welwyn Garden City 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 have completed work to make the centre an approved base for training for the Tetra Working at Height system and have launched an innovative programme of diagnostic training for call centre agents, delivered to Mears 24/7 and to clients with significant acclaim.

## Making a positive difference locally through apprentices

Mears' Brighton branch was named as the South Central's **best employer of apprentices** in the regional final of the National Apprenticeship Awards 2013.

Mears has supported the Apprentice Framework in partnership with City College Brighton since 2005. This commitment to apprentices has grown steadily throughout the years and currently employs 25 apprentices locally. The success rate for graduate apprentices is high, with six having recently been retained and employed by Mears.

A summer school saw 130 attendees aged from 15 to 40 gain carpentry experience working on the Brighton Waste House, a collaboration involving Mears, Brighton University and City College Brighton from which a further four carpentry apprentices were recruited and helped others gain local employment.

In order to help support young people in the community who are not yet ready for an apprenticeship, Mears Brighton (in partnership with City College) is also offering programmes providing essential work experience for 16 to 24 year olds. Trainees are able to explore different work environments to help with their career choices and gain experience to improve their CV. This innovative project is helping raise aspirations and reduce barriers to higher education.

**Our business model in action**
» People

Having begun the year as empty warehouse space, by the close of 2013 the centre had delivered training to over 200 people. We were also delighted to inherit the Rotherham training centre from the Morrison acquisition and now have these two academies to support the Group's expanding L&D programme.

Mears Care ensures that staff are properly trained for their job roles. We focus on training requirements as identified in appropriate regulations and those needed to ensure that fundamental job tasks are fulfilled and that staff are fully motivated.

Mears Care has a Training Centre of Excellence, committed to ensuring that the skills and development of our workforce remain a key priority. This means ensuring our workers are trained above industry standard, implementing best practice at all times to reflect the evolving nature of homecare.

All of our trainers are suitably qualified to provide training in the relevant subjects to a high standard.

Our in-house training team is continually reviewing and updating our training courses in line with changes in Skills for Care standards, legislation or the Government agenda. This can be highlighted through our induction course modules, which are centred upon personalisation, and through the introduction to dementia courses as part of the induction programme in response to the ever-growing ageing population and the anticipated increasing number of cases of dementia in the coming years.

### Future outlook

Heading into 2014 our priorities include the revitalisation of some of our core housing processes, most notably induction. Our aim is to increase the speed and efficiency with which new employees become job ready at all levels and to echo best practice found within our well respected Care induction programme.

# Corporate responsibility

Our aims remain unchanged: the sharing of best practice across the business; activity that represents value for money; and structured plans that will support the current and future needs of the Group as it evolves.

## Mears' sustainability strategy has five guiding principles:

### 1 Long-term customer relationships

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

### 2 Excellent employee experience

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

### 3 Responsibility for the environment

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

### 4 Responsible leaders

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

### 5 Diversity in our business

We see diversity as a strength.

Read more about governance measures on **pages 38 to 42**

## Putting customers and communities first

We believe that the most important aspect for a sustainable business is to focus continually on the needs of customers. The repairs and maintenance arm of Mears Group 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. We retained this accreditation in 2013.

Commitment to local communities is seen at every level of the organisation and during 2013 our staff volunteered over 64,000 hours and supported 753 community projects across the UK.

As Local Authority funding cuts have impacted local communities and third sector providers, the Mears Serving our Communities programme has made a significant difference to people's lives.

During the year there has been a focus on impact and outcomes and individual projects have been delivered on a large scale.

Local employment advisory forums have been held in a number of locations in England. These events have provided advice to over a thousand people relating to skills, education, employment and personal development.

In response to the alarming statistic that shows that loneliness is a bigger killer in the over 65s than smoking, the Mears Befriending scheme provides a national service connecting volunteers from within the business with socially isolated people who are in need of regular conversation and human contact.

The Mears Care, Housing and 24/7 Contact Centre businesses have worked together to help raise awareness and understanding of those most vulnerable customers suffering from dementia. There are now 81 trained Mears Dementia Friends within the business.

## Developing a great workforce

Mears has once again retained its Investors in People (IIP) accreditation. We have held this accreditation since 1994 and we continue to actively seek feedback and listen to our staff.

Significant effort is put into communicating well with staff at all levels at Mears. 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.

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## Mears' Local Employment Advisory Forum (LEAF)

Through our LEAF events **we bring together employers in the areas where we work**, to meet and provide advice and opportunities to young people and to the long-term unemployed.

We work in some of the most deprived areas of the country and take our responsibilities here very seriously.

Mears, in partnership with Barnsley and Rotherham Chamber of Commerce and Rotherham Borough Council and Job Centre Plus, hosted a LEAF event at the New York Stadium, Rotherham. Some 35 employers and colleges, ranging from banks to mechanical engineering companies, provided advice and guidance to over 500 people from the local community, mostly school children looking for direction on their future careers.

The event was given a High Impact award as a contribution to Global Entrepreneurship Week.

Our daily news snippet is emailed to everyone with a Mears address and we 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 9,000 employees and their families attended our two Family Fun days in England and Scotland in 2013.

During 2013 we continued our commitment to apprentices with 150 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 370 apprentices in our repair and maintenance business. A similar programme has been launched in our Care business.

Mears Housing now has training centres in Welwyn, Peterborough, Rotherham and Birmingham. These 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.

We have a clear 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 2013, we achieved continued improvements in environmental performance. Through our partnerships, Mears has achieved a reduction in costs even when faced with increasing pricing pressure when dealing with waste. We have also 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.

In 2013 we successfully merged the Mears and Morrison systems into one robust Safety Management System, including the integration of ISO 9001, 14001 and OHSAS 18001 using the best of both company systems. All of these standards are now accredited under one accreditation body, which has not only reduced costs but also ensures that we are all operating to the same standard.

Read more about our Care services online at **www.mearshomecare.co.uk**

# **Corporate responsibility** continued

## Helping the environment and reducing energy bills for our clients

In November 2013, Mears started delivery of a **landmark energy efficiency programme**, on behalf of Social Landlord, livin.

The project, funded partly through the Government's Energy Company Obligation (ECO) initiative, sees residents in the North East of England benefiting from a range of energy efficiency improvements to their homes – making them warmer and more cost effective to run.

Measures such as internal and external wall insulation and loft insulation will allow householders to reduce the amount of energy used to heat their homes and mitigate the effect of any possible future energy price increases. In essence the project benefits both the resident and the environment by significantly reducing the amount of carbon emissions from each property treated. The average tenant has seen their annual bill reduce by £300 and over 5,000 tonnes of $C0_2$ have been saved.

Mears sourced funding from the ECO programme for livin of around £500,000 to contribute and enable the project along with providing an end-to-end delivery solution. This capability is one which is being replicated by Mears in projects across the UK under the current ECO initiative, which will run until March 2015.

## Protecting the environment and tackling fuel poverty continued

We recognise the importance of measuring and addressing our own carbon footprint. Our most recent study relating to Mears' travel and energy usage showed that in 2011 we generated 18.861.27t of carbon emissions. We have a clear plan in place to mitigate our carbon footprint. In 2011, we received confirmation that our Forestry Project in Scotland can offset 11,745t of carbon.

## Greenhouse gas (GHG) emissions

This year's GHG emissions data has been calculated using the 2013 set of conversion factors provided by the UK Government. Subsequent years' emissions reporting will be based on the annually revised set of factors. Based on these conversion factors, the Group's total GHG emissions for its operations as at 31 December 2013 were:

| GHG emissions by scope | Unit | Quantity |
|---|---|---|
| Scope 1 | Tonnes $CO_2e$ | 16,375 |
| Scope 2 | Tonnes $CO_2e$ | 2,087 |
| Scope 1 and 2 intensity | Tonnes $CO_2e$/£m revenue | 21.33 |

## Responsible business leaders

Providing our employees with a safe working environment is paramount. In the year, we have reduced our accident frequency rates by 10% through increased awareness training and site inspections. 2013 not only proved to be a safer year than 2012 but we also trained more operatives and managers. In 2013 we introduced new initiatives aimed at our main health and safety risks within the business, which not only reduced the accidents and incidents but also raised the profile across the Group. Our accident rates continue to reduce year-on-year. Again in 2013 we retained our RoSPA Gold Award, being highly commended as this was our eleventh consecutive Gold Award.

In 2013 through the development of in-house courses, not only are we bringing more specific courses to our workforce, but are also substantially reducing our overall training costs.

We have continued to grow the safety function within Mears Care; this in turn has developed more robust and standardised processes and procedures.

**Accident frequency rate** (%)

**0.32**

| Year | Rate |
|---|---|
| 2009 | 0.43 |
| 2010 | 0.41 |
| 2011 | 0.36 |
| 2012 | 0.35 |
| 2013 | 0.32 |

Target – year-on-year improvement

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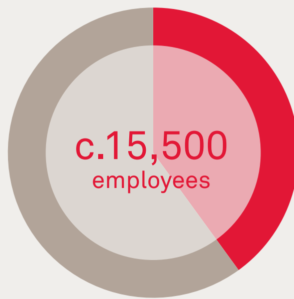
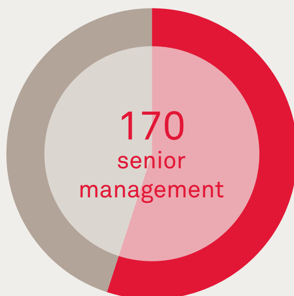
## Workforce makeup

**All staff**




| | |
|---|---|
| Male | **41%** |
| Female | **59%** |

**Senior management***




| | |
|---|---|
| Male | **55%** |
| Female | **45%** |

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

**Mears' recycling rates are now**

**>92%**

## Valuing diversity

Mears has a diverse workforce of over 15,000 staff, the vast majority of whom live directly in the areas in which they work.

Mears is fully aware of its responsibilities as a service provider of public services to ensure full equality of access to both services and opportunities.

We have a published Code of Conduct that is issued to all staff and to which they are to adhere to at all times. The Code of Conduct summarises our commitment and expectations in terms of equality and diversity whilst also detailing what our staff must do and how they must behave.

We carry out equality (including disability) impact assessments of all new and existing policies and practices to ensure that Mears does not discriminate against anyone, with the aim of removing barriers which deny people access to our services and/or providing alternative methods of access to services.

We have invested heavily in developing working practices and implementing initiatives to raise awareness and to promote social inclusion and ensure equitable access and service delivery throughout all of our partnerships.

We promote positive attitudes to equality throughout all that we do and incorporate this within all policies and procedures, employee handbooks, induction and continued training and development.

Equality and diversity training is an integral part of our Management Development Training and Induction programme. Diversity and dignity and respect for all are explicit modules within our training on recruitment and selection, customer care and disciplinary procedures.

Training is reinforced through our employee handbook. All employees know the attitudes, behaviours and professionalism that we expect at all times.

We review our policies at least annually and immediately following any update or change to applicable acts, legislative or statutory requirements and best practice. Mears is proactive in identifying best practice and innovation in equality and diversity, recruitment, retention and monitoring. When reviewing and enhancing policies we monitor and measure current and target performance against employee diversity profiles, actions from Equality and Diversity Action Plans and Equality Impact Assessments to further ensure our polices are fully contributing to our vision and aims. We expect our suppliers to operate to the same standards that we follow.

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# Key performance indicators

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

## Service delivery and contract bidding

Our service delivery leads the market, although **we continue to strive for better.** We are also **recognised as being better**, which drives our contract bidding success.

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

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

2013 target >80% — Out performance

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

This is an excellent outcome, despite the diluting impact from Morrison. We continue to focus upon training and development of our staff and we work closely with our customers, tenants and service users to achieve this.

| Year | Result |
|---|---|
| 2013 | 82% |
| 2012 | 80% |
| 2011 | 80% |

Target for 2014 **>83%**

### 2 Number of customer complaints

2013 target <0.28% — Under performance

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.

Our customer complaints have edged upwards during the year. The incorporation of Morrison within our performance metrics, during a period of integration, has had a diluting impact in respect of performance. We continue to strive for better.

| Year | Result |
|---|---|
| 2013 | 0.31% |
| 2012 | 0.29% |
| 2011 | 0.30% |

Target for 2014 **<0.28%**

### 3 Jobs completed on time

2013 target >92% — On track

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

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

| Year | Result |
|---|---|
| 2013 | 92% |
| 2012 | 92% |
| 2011 | 92% |

Target for 2014 **>92%**

### 4 Social Housing new contract success rate

2013 target 33% — Under performance

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

Whilst the success rate is adequate, the removal of a major competitor in Morrison could have driven a better outcome. The level of new tenders reaching their conclusion was lower than expected which does depress this measure.

| Year | Result |
|---|---|
| 2013 | 32% |
| 2012 | 32% |
| 2011 | 43% |

Target for 2014 **33%**

### 5 Order book growth

2013 target +10% — Under performance

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

We are pleased with this outcome. Whilst below our target, the Group delivered record revenues of circa £900 million in 2013 (much of which is an outflow from the order book). 2013 had fewer new bidding opportunities.

| Year | Result |
|---|---|
| 2013 | 2% |
| 2012 | 31% |
| 2011 | 7% |

Target for 2014 **+10%**

### 6 Revenue secured

2013 target 95% — Under performance

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. It is imperative that at the start of any financial year, a significant proportion of that year's orders are already secured.

Whilst 90% visibility is excellent, given the significant time-period between being awarded a contract and its mobilisation, it is important for us to have a high level of visibility as we enter a new year. This shortfall represents a challenge for 2014.

| Year | Result |
|---|---|
| 2013 | 92% |
| 2012 | 88% |
| 2011 | 95% |

Target for 2014 **95%**

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Read more in the review of operations on **pages 26 to 31**

Read more in the financial review on **pages 32 to 35**

# Our financial outputs

Our **strong financial performance** is as a result of our differentiated strategy and a commitment to open and trusted management disciplines.

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

## 7 Social Housing maintenance revenue – organic revenue growth

2013 target +10% — On track

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

We are pleased with the level of our Social Housing organic growth. As the business gets bigger, double digit growth becomes increasingly challenging however the opportunities remain strong in both our core divisions.

| Year | Result |
|---|---|
| 2013 | +10% |
| 2012 | +19% |
| 2011 | +14% |

Target for 2014: **+6%**

## 8 Social Housing – operating margin

2013 target 4.3% — Out performance

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.

This is an excellent outcome. The Morrison business, which was loss making at the time of acquisition, resulted in some margin dilution. The outcome in 2013 was ahead of plan.

| Year | Result |
|---|---|
| 2013 | 4.5% |
| 2012 | 4.7% |
| 2011 | 5.8% |

Target for 2014: **4.6%***

* A blend of 5.7% on the existing business, 2.0% on the acquired Morrison business.

## 9 Care – revenue growth

2013 target +2% — Out performance

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

The Care growth at 9% is entirely driven by the ILS acquisition. We have reported no organic growth in 2013 which, whilst well communicated, remains disappointing. We anticipate a similar outcome in 2014 however we believe the medium-term opportunity is exciting.

| Year | Result |
|---|---|
| 2013 | +9% |
| 2012 | +4% |
| 2011 | +8% |

Target for 2014: **+2%**

## 10 Care – operating margin

2013 target 8.0% — Under performance

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

The Group took the decision to increase the infrastructure supporting our Care division providing more robust operational and financial management. We anticipate continued margin pressure in Care in the short term.

| Year | Result |
|---|---|
| 2013 | 7.8% |
| 2012 | 8.3% |
| 2011 | 8.0% |

Target for 2014: **7.8%**

## 11 Profit to cash conversion

2013 target >80% — Out performance

The efficiency with which the Group manages working capital remains a cornerstone of our business. The key measure is cash inflow from operating activities as a proportion of EBITDA.

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

| Year | Result |
|---|---|
| 2013 | 103% |
| 2012 | 108% |
| 2011 | 85% |

Target for 2014: **>75%**

## 12 Normalised diluted EPS

2013 target +7.0% — Out performance

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

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

| Year | Result |
|---|---|
| 2013 | 10.0% |
| 2012 | 6.7% |
| 2011 | 11.2% |

Target for 2014: **>10%**

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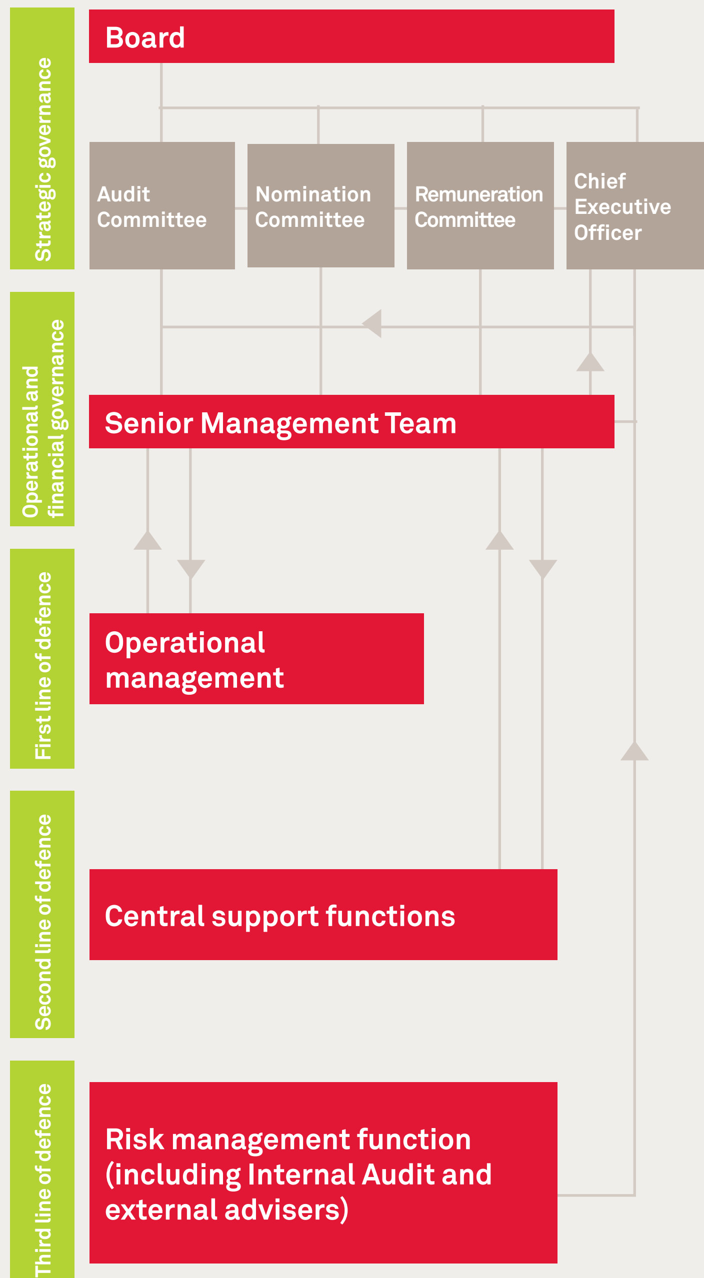
# Risk management and principal risks

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

## Risk management process




### The Board

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

### The Audit Committee

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

### The Senior Management Team

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

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

The Senior Management Team has responsibility for managing the Group's key risks.

### Risk management function

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

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

Details of financial risk management and exposure to price risk are given in note 21 on **pages 104 to 108**

Read more about governance measures on **pages 38 to 42**

Read more about the Audit Committee on **pages 44 to 47**

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# Risk management

In line with the FRC guidance, **we have endeavoured to simplify our reporting of our key risks** to ensure that shareholders understand those principal risks which we see as business critical or potentially catastrophic.

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

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

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

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

# Principal risks

## Risk and description

### Reputation

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

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

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

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

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

**Performance measures:**
CQC audit scoring, whistleblowing statistics

## How we mitigate the risks

- In-house IT system developed to provide operational management witha real time dashboard of service delivery indicators.
- Internal auditing of KPI reporting including 'mystery shoppers'.
- Well communicated policy for dealing with press enquiries and incident management.
- Care risk plans for dealing with vulnerable customers.
- Compliance management of bribery and corruption legislation and whistleblowing policy.
- We induct and train all new starters. This induction ensures that all employees understand our values and it reinforces the Group's culture.
- We ensure that staff are properly trained for their roles. We ensure that we deliver relevant training and implement best practice.

# Risk management and principal risks continued

## Principal risks continued

| Risk and description | How we mitigate the risks |
|---|---|
| **People**<br>**A failure to attract, develop, motivate and retain quality people at all levels in the organisation will have a significant impact upon the Group delivering against its strategic objectives.**<br>Notably in our Care division, recruitment and retention remains the biggest inhibitor to achieving our growth aspirations.<br>We have over 15,000 employees – the majority of these employees are interacting with our customers on a daily basis. It is this day-to-day front line contact that is fundamental in delivering a differentiated service and maximising customer satisfaction. It is therefore imperative that the Group's strategic goals are well communicated and understood by all employees.<br>Mears sees sound commercial management of contracts and the business as a whole as essential to achieving our objectives. The success of the Group is underpinned by the delivery of services profitably whilst exceeding our clients' expectations and our contractual obligations.<br>**Performance measures:**<br>Employee turnover, employee training statistics, employee pay benchmarking, sickness records, grievance statistics, exit interviews | » We induct and train all new starters. This induction ensures that all new employees understand our strategy, vision and values.<br>» We regularly review and benchmark our remuneration packages to ensure that they remain competitive.<br>» In Care, the market is highly price driven which has made it difficult to provide better rewards. Our Local Authority clients will not typically commit to any guaranteed work volume, which has made zero hour contracts commonplace. We have canvassed the sector and Government to encourage outcome-based care contracts and associated incentives and rewards which can be shared with our front line carers. Our new pioneering Wiltshire outcome-based contract is hopefully the first of many that result from our influence and success.<br>» In Care, an increased level of resource and focus is being applied to recruitment; a more robust process in respect of handling, processing and tracking applicants is expected to increase the volume of quality carers. Local Care branches are targeted on a monthly basis in the area of recruitment and retention.<br>» At the senior end of the business we have increased our focus on succession planning and increased our investment in senior management development. During 2013 we commenced a Senior Leadership Programme which has identified a cross section of the Group's brightest talent that we would envisage will play central roles in our future business.<br>» The Group's Learning & Development strategy was launched during 2012 and has undertaken a number of key initiatives with a view to investing in management trainees, skills academies and apprenticeship schemes to ensure there is a constant inflow of new talent. These are detailed further on pages 14 and 15.<br>» An annual appraisal process is completed for all employees to ensure that all people receive feedback in respect of their performance as well as identifying future training and development requirements. In 2013 we have once again secured the national accreditation as an Investor in People.<br>» We are continuously looking to improve our position as an employer of choice by improving the level of engagement with our employees through formal communications, awards to recognise success, local events and family fun days.<br>» Continual monitoring of our future skills requirements.<br>» We regularly undertake employee surveys to gauge employee satisfaction, engagement and any barriers to high level performance. |
| **Health and safety**<br>**Mears' services and operations involve a series of high risk activities ranging from dealing with vulnerable customers in need of our care, to our building related services e.g. working at heights, working with gas and electricity and dealing with asbestos.**<br>Failure to have robust and safe systems of work could lead to serious personal injury or a fatality. In addition such a failure could lead to financial penalties and significant reputational damage.<br>**Performance measures:**<br>Accident frequency rate, reportable incidents, continuous review of employers' liability insurance claims | » Significant investment in single centralised HSE function to maintain consistency and quality.<br>» Comprehensive safe systems of work which are well communicated through a robust and coordinated internal training regime.<br>» Robust process of inducting new staff to ensure importance of health and safety is emphasised together with detailed method statements for working safely.<br>» Regular HSE training and updates predominantly delivered by internal function<br>» Significant resources have been invested to claims defensibility to ensure that invalid claims can be robustly defended.<br>» Internal SHE auditing and third party validation.<br>» Annual Group SHE strategy and plan. |

# Additional risks

## Our markets

Pages 10 to 13 detail both our core markets, together with what we see as change drivers and with the elements which underpin our future growth. Both markets are subject to Government legislation and are impacted by the political environment, local or national, including public sector policy and funding. Any changes in policy could have a detrimental effect on the Company's business.

## Integrity, ethics, anti-bribery and corruption

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

## Taxation, legal and regulatory

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

## Business continuity

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

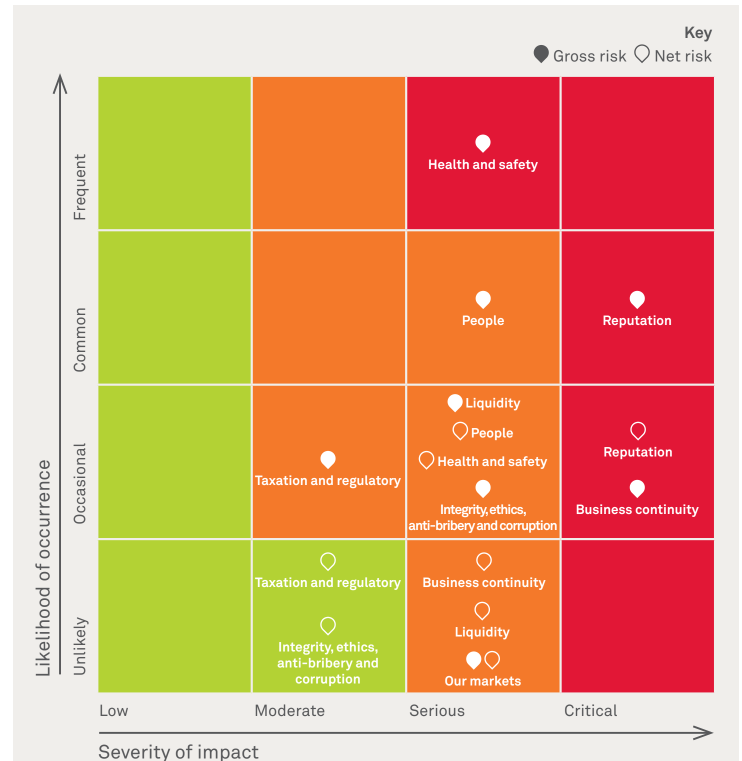
## Liquidity

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

**The Strategic Report was approved by the Board of Directors on 28 March 2014 and signed on its behalf.**

**D J Miles**
**Chief Executive Officer**
david.miles@mearsgroup.co.uk
28 March 2014

# Prioritising our risks




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

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

Read more key performance indicators on **pages 20 and 21**

# Review of operations

Our relationship with our customers continues to be strong and our partnering ethos is recognised widely. This is demonstrated by the number of customers awarding, as well as renewing, contracts to the Group across a wide array of their activities.

**David Miles** Chief Executive Officer

## In summary

### Group

This has been a year of significant progress. The disposal of our non-core Mechanical & Electrical business has allowed the Board to focus even more on our core operations of Social Housing and Care.

### Social Housing

The Social Housing division made excellent progress in 2013, with the integration of Morrison exceeding our expectations in terms of contract retention, service delivery and the financial turnaround. 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. As we seek to broaden the services we offer across the sphere of Social Housing, we will look to make further acquisitions to reinforce our market-leading position.

### Care

The award by Wiltshire of an innovative partnering contract to Mears represents our most important milestone since entering into Care and an important development in the Care market in the UK. Wiltshire signals a move away from traditional 'task and time' based contracts to ones that are more outcome based. We continue to see the trend towards the joint commissioning of NHS and Local Authority services. We believe that a market-leading approach to service quality and innovation through the application of technology puts the Group in a strong position.

| | Revenue | | Operating profit* | | Profit before tax* | |
|---|---|---|---|---|---|---|
| | **2013 £m** | 2012 £m | **2013 £m** | 2012 £m | **2013 £m** | 2012 £m |
| Continuing activities | **865.6** | 617.2 | **41.1** | 32.8 | **39.3** | 30.8 |
| Discontinued activities | **32.6** | 62.3 | **(2.7)** | (1.6) | **(2.6)** | (1.8) |
| **Total** | **898.2** | 679.5 | **38.4** | 31.2 | **36.6** | 29.0 |

* Before amortisation of acquisition intangibles and exceptional items.

This has been a year of significant progress. Revenues increased by 32% to £898.2m (2012: £679.5m) and delivered a profit before tax and before amortisation of acquisition intangibles and exceptional items of £36.6m (2012: £29.0m), an increase of 26%. The normalised diluted earnings per share on the same basis increased by 17% to 28.06p (2012: 23.91p). Given the losses generated by Morrison in 2012, a better indicator of performance is to utilise the pre-Morrison normalised diluted earnings per share in 2012 of 25.60p. This results in an increase in earnings per share in 2013 of 10% which represents an outstanding achievement and better reflects the performance of the business and management. In line with the Company's progressive dividend policy, the Board is recommending a final dividend of 6.30p per share (2012: 5.70p) making 8.80p per share for the year (2012: 8.00p), an increase of 10%, reflecting the Board's confidence and ongoing strong cash performance.

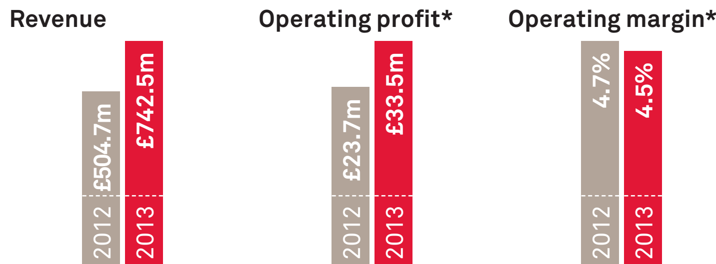
We continue to place great emphasis on cash collection and to develop further the cash culture within the Group. I am delighted with our continuing strong working capital management, with cash generated from continuing operations as a proportion of EBITDA amounting to 103% (2012: 108%).

The disposal of our non-core Mechanical & Electrical business has allowed the Board to focus fully on our core operations of Social Housing and Care. Revenues from continuing operations increased by 40% to £865.6m (2012: £617.2m) with operating profit on continuing operations before the amortisation of acquired intangibles and exceptional items increasing to £41.1m (2012: £32.8m). The non-core Mechanical & Electrical business delivered an operating loss of £2.7m in the period leading up to its disposal in November 2013 (2012: loss £1.6m).

Whilst we have delivered record revenues, it is pleasing that we have also maintained the order book at £3.8 billion. The demand for our services continues to be strong with a bid pipeline in excess of £3.0 billion. We enter the current year with a visibility of 92% of the £908m consensus revenue forecast for 2014. Moreover, we have a visibility of 70% of the consensus revenue forecast for 2015, which demonstrates both the long term nature of our business and our leading market position.

We are well placed to benefit from the immediate bid pipeline and the wider opportunities in our core markets. Our relationship with our customers continues to be strong and our partnering ethos is recognised widely. This is demonstrated by the number of customers awarding, as well as renewing, contracts to the Group across a wide array of their activities.

## Social Housing




* Before acquired intangible amortisation, exceptional costs and the long term management incentive plan.

The Social Housing division made excellent progress in 2013, with the integration of Morrison exceeding our expectations in terms of contract retention, service delivery and financial turnaround. The existing Social Housing business also benefited from a period of consolidation, following the previous year's particularly intensive period of new contract mobilisations.

The Social Housing division, prior to the inclusion of Morrison, reported revenues of £507.5m (2012: £459.7m), reflecting organic growth of 10%. This growth was primarily generated from the full year effect of the 2012 mobilisations. The new contracts are now at an advanced stage of their mobilisation cycle and are generally performing well. I was particularly pleased to see our contract with London Borough of Southwark, which was initially the subject of a single year award under emergency measures, be re-awarded on a long term basis. This is typical of our approach to provide solutions for our clients and is reward for our significant early investment.

The Social Housing division, with the inclusion of Morrison, reported revenues of £742.5m (2012: £504.7m), growth of 47%. Morrison itself delivered revenues in the year of circa £235.0m (2012: £45.0m) which was higher than anticipated, driven by the backlog of works that had accumulated in the period leading up to the acquisition. Moving forward, we expect a run-rate flowing from the Morrison contract estate of circa £210m per annum. The Group has been delighted at the strong retention rate of Morrison contracts.

Our Social Housing activities delivered an operating margin of 4.5% (2012: 4.7%). Our target for the year was an operating margin of 4.3%, which was derived from a blend of a normalised margin within our existing business of 5.7% combined with a Morrison margin of 1.0%. It is pleasing to have met our margin aspirations, given the significant losses being generated by Morrison at the time of the acquisition.

Following the acquisition of Morrison we restructured the senior operational management and support functions servicing the combined Social Housing division. As anticipated, this realised significant financial synergies. Whilst the cost of this restructure amounted to £8.5m across the two accounting periods, this unlocked a synergy saving in excess of £10m per annum and has underpinned Morrison returning to profitability. It also provided an opportunity to combine the strengths of both organisations and enhance operational delivery and control. The migration of all Morrison contracts across to the Mears IT platform is now complete.

All Social Housing contracts are run from our contact management system which will inevitably drive better service delivery and more robust financial control. The strong cash performance during the period, and the reduction in trade receivables, was driven in part by the better visibility provided as to the financial position of the Morrison contracts following these system migrations. The key focus is now at an individual contract level to maintain the improved service delivery whilst continuing to resolve the remaining financial challenges.

The Decent Homes programme is now in the past and 2013 was the first time for a number of years where the revenue figures are not impacted by that revenue decline. As anticipated, the changes over recent years in housing finance combined with annual rent rises have increased the funding available to our clients to invest in their housing stock.

A number of our clients have reported strong surpluses on their ring-fenced Housing Revenue Account (HRA) and we have seen an increasing number of opportunities flowing from this. Whilst these opportunities are HRA funded, they are typically of a more discretionary nature. We would expect this trend to continue.

**In focus**
Making a positive difference locally through apprentices
page 15

**In focus**
Helping the environment and reducing energy bills
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**In focus**
Providing support to those with additional health needs
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# Review of operations continued

## Mears Nurseplus

Providing **more complex services** to meet increasing NHS requirements: Mears Nurseplus.

Mears Nurseplus provides support services to adults and children with additional health needs that include spinal injury, brain injury and degenerative conditions. With the greater integration of NHS and social services, we see significant opportunities for growth.

Packages that are nurse led are tailored to meet the individual needs of the service user. Mears Nurseplus currently operates in Scotland and has been the fastest growing part of our Care business. We obtained registration for these services in England towards the end of 2013 and expect to see strong growth in 2014.

**Our business model in action**
» Services

Read more about our business model on **pages 04 and 05**

## Social Housing continued

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

During the year, we were pleased to announce two acquisitions which together will accelerate our capabilities and increase our credibility to help tackle a wider range of clients' white collar housing management challenges. Both acquisitions were made for nominal considerations and will enhance Mears' ability to build workable solutions to meet our clients' evolving needs.

- The acquisition of the entire issued share capital of Plexus UK (First Project) Limited ('Plexus'). Plexus is a registered Social Landlord with a portfolio of circa 400 properties within Central London. Plexus acts as a conduit between private Landlords and Social Housing providers, helping Local Authorities to address homelessness issues by procuring decent affordable homes for their customers.
- The acquisition of a 50% interest in the trade and assets of JustCall 24/7 Limited, a provider of call centre services to a large number of Social Housing providers. This acquisition also brings expertise that includes the management of direct labour organisations, void lettings and rent collection.

In both cases, the acquired capabilities and credibility will be leveraged using Mears' unique service offering of a national customer base, differentiated partnering ethos and market leading levels of customer service and innovation. These two businesses will provide the opportunity to build a significant broad based offering to our prime market in Social Housing, making Mears even more relevant to customers and tenants.

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. As we look to broaden the services we offer across the sphere of Social Housing, we will look to make further acquisitions to reinforce our market leading position.

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.

# Supporting Social Housing with North Lanarkshire Council

A pioneering partnership, involving North Lanarkshire Council and Mears, is **delivering one of the best housing repairs services** in Scotland.

Mears provides repairs and maintenance services to over 37,000 homes and in excess of 500 public buildings on behalf of North Lanarkshire Council as part of a unique joint venture in which Mears has a 67% share. The ten year contract which started in 2011 was as a result of a successful re-bid and is valued at £37m per annum. Within the contract we also support a sheltered workshop, where we work with the community to provide employment and training.

**Our business model in action**

» Services

Read more about our business model on **pages 04 and 05**

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 has improved to 82% (2012: 80%). Typically others in the sector measure only satisfaction whereas our drive has always been for excellence. Service quality remains our key differentiator although we continually strive for better.

### New contract bidding

The Group has continued to experience success in winning new contracts. In Social Housing we have won 33% (by value) of all contracts bid, with a total value in excess of £420m. The most significant awards are detailed below.

| Contract | Detail |
|---|---|
| Hyde Housing Association (Hyde) | We were awarded a number of contracts with Hyde. The contracts are worth up to £74m over the initial ten year period. We will be providing responsive repairs and voids services for two of Hyde's regions in London and Minster. We have also been awarded internal and external planned maintenance contracts for the Minster region worth £6m as part of a four year framework arrangement. Hyde owns circa 48,000 homes across London, Kent and Minster regions. |
| London Borough of Southwark (LBS) | We secured a repairs and maintenance contract with LBS. The contract is worth £58m for the initial five year period. We will be providing responsive repairs and voids services and an out-of-hours facility to the Council. There is an option to extend the contract for a further five years taking the total opportunity to £115m. LBS is an existing valued client of Mears; we were awarded a twelve month interim repairs contract in 2012. |
| Affinity Sutton (Affinity) | We have been awarded a five year contract with Affinity. The contract is worth up to £60m over the initial five year period. The contract covers Kent, the Southern Home Counties and Dorset. Affinity manages 12,500 properties in those regions. There is an option to extend the contract for a further five years, taking the total opportunity up to a potential £120m. The award is subject to contract and leaseholder consultation. |

# **Review of operations** continued

## Transforming Care with Wiltshire Council

Wiltshire Council entered into a partnership with Mears in September 2013 to deliver care services across six areas in the south of the county and part of East Wiltshire around Devizes as part of the council's **groundbreaking Help to Live at Home service**.

In a move away from traditional care contracts, Mears is not paid on a task and time basis; instead, the Council has adopted a payment by results model which pays providers on meeting desired outcomes that have been agreed directly with service users.

In order to achieve the outcomes, Mears is harnessing and making the best use of a full range of technology and resources which is typically beyond the scope of a traditional care contract. This includes aids and adaptations, telecare, community equipment as well as looking to create partnerships with community groups and charities.

Working closely with local health services, the Help to Live at Home service is designed to enable rapid hospital discharge and strong links with local hospices is allowing palliative care to be provided in people's own homes.

The five-year contract with a possible two-year extension offers length and stability and enables providers to move away from zero hours contracts and actively encourages career development for care workers who are also rewarded on outcomes.

## Care

**Revenue**

**Operating profit***

**Operating margin***

* Before acquired intangible amortisation and exceptional costs.

I am delighted by the advances made within our Care business during the year. The improvements made within both the wider Care sector and our own Care business, together with the significant shift now being witnessed in respect of the commissioning of Care, underpins our confidence for the medium and long term.

We entered the Care market in 2007 with a clear strategic vision that the market would develop in a way similar to that of Social Housing. Notably, we expected to see a shift towards output-based contracts, where vendor payments are based on the quality of the outcome for the recipient rather than simply based on the time spent in delivering the service. We also expected to see a consolidation where contracts are awarded for the longer term to fewer providers who could provide a broader service to clients and also assist those clients in driving efficiencies within their own cost base. We have positioned ourselves as a high quality business focused upon service delivery in readiness for the market change. The speed of change prior to 2013 was extremely slow; however, the changes seen during 2013 and the head of steam that has now built up vindicates our strategy. The award by Wiltshire of an innovative partnering contract to Mears represents our most important milestone since entering into the Care sector and an important development in the Care market in the UK. In a move away from traditional 'task and time' based contracts, Mears will be paid by results, based upon meeting desired outcomes that have been agreed directly with service users. That Mears was awarded this landmark contract demonstrates Mears' leading position in the Care market. The contract, which mobilised in September 2013, has started positively.

While still early days, there are indications now that a number of other Local Authorities are looking to follow the lead of Wiltshire. It will be particularly beneficial to Mears that Wiltshire is a strong reference site to support the Group securing other similar opportunities.

In April 2013, Mears acquired the entire issued share capital of ILS Group Limited (ILS), a leading homecare company. ILS provides high quality community based care services to approximately 3,400 service users in Scotland and has contracts with 20 Local Authorities, employing over 1,600 staff. The acquisition was in line with Mears' strategic objective for its Care business which is to increase the level of work in higher acuity services. An important reason for acquiring ILS was for its greater proportion of work in higher acuity activities, which are delivered through the Nurseplus brand.

These activities have made strong progress with an increase in volume of over 25% since acquisition, driven from securing new high acuity packages with the existing Mears customer base which had not been served previously. The business has now been fully integrated and the structure of the Care business has been further enhanced under two divisional managers covering the north and south of the UK.

The Care division reported growth of 9% with revenues increasing to £123.1m (2012: £112.6m). This growth in Care revenues is driven by the acquisition of ILS. Whilst we anticipate low organic growth in Care in 2014, we continue to anticipate this sector providing significant medium-term growth opportunities.

The Care operating margin was 7.8% (2012: 8.3%). The Care division has, over recent years, continuously looked to drive efficiencies in overhead whilst keeping tight control on direct costs. In an environment which continues to see pricing pressure, we have looked to invest further in our infrastructure and processes to support future development and growth. Whilst this investment has resulted in some short term margin dilution, we believe it leaves the division on a firmer footing.

The Board is pleased with the performance of the Care division in terms of the quality of service and market positioning. We continue to see the trend towards the joint commissioning of NHS and Local Authority services. We believe that a market leading approach to service, quality and innovation through the application of technology puts the Group in a strong position.

### New contract bidding

In Care, contract bidding success rate (by value) of all contracts bid was 69%, amounting to a total value of £96.3m, including the amounts shown in the table below.

We have continued to develop our partnership thinking into new areas such as assistive technology. We have been awarded a contract to monitor the telecare alarms for around 10,000 vulnerable people across Lincolnshire. This is the first monitoring contract won by Mears. When an alarm is triggered, Mears will contact the service user and initiate a response dependent on the severity of the situation. We would hope to win more contracts of this type in 2014.

## 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 customers. We will continue to differentiate ourselves through outstanding customer service.

In Social Housing, we expect to broaden the services we offer to our clients across a wider range of housing related services. We will continue to grow through further contract wins, underpinned by our market leading service delivery. We will look to enhance and broaden our offering through partnerships and acquisitions.

In Care, we will continue to move further up the acuity chain through acquisition and organic growth, extending the Mears Nurseplus model across our national client base. This will increase our ability to respond to growing opportunities from Health and Social Care outsourcing and the implementation of new localised commissioning models.

**D J Miles**
**Chief Executive Officer**
david.miles@mearsgroup.co.uk
28 March 2014

| Client | Services | Term (base period + extension) | Value per annum | Base value |
|---|---|---|---|---|
| Cheshire West and Chester Council | Extra Care schemes | 5 + 0 years | £2.6m | £12.9m |
| Wirral Council | Homecare support services | 3 + 0 years | £2.9m | £8.6m |
| Wiltshire Council | Help to Live at Home services | 5 + 0 years | £6.0m | £29.8m |
| Northamptonshire County Council | Personal care services | 4 + 0 years | £1.3m | £5.2m |
| Aberdeenshire Council | Supported living – learning disability | 2 + 2 years | £2.8m | £5.5m |

# Financial review

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

**Andrew Smith** Finance Director

Group revenue
**£898.2m**
(2012: £679.5m)

Dividend per share
**8.80p**
(2012: 8.00p)

Group operating profit*
**£38.4m**
(2012: £31.2m)

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

Cash conversion – continuing activities
**103%**
(2012: 108%)

## In summary

### Earnings
The normalised diluted EPS, which allows for the potential diluting impact of outstanding share options, increased by 10% to 28.06p (2012: 25.60p).

### Dividend
The Board has recommended a final dividend of 6.30p per share which, combined with the interim dividend, gives a total dividend for the year of 8.80p (2012: 8.00p), a 10% increase.

### Cash
The efficiency with which the Group manages working capital remains a cornerstone of our business. The Group's conversion of EBITDA to cash in the period was 103% (2012: 108%). The Group has agreed a two year extension to its £120m unsecured revolving credit facility, with the new expiry date of July 2018.

Read the report of the Audit Committee on **pages 44 to 47**

View the primary statements on **pages 82 to 86**

## 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.

## Disposal of Mechanical & Electrical business (Haydon)
Haydon had been running at a loss for a number of years and was non-core as the major focus of the Group is in respect of developing our two core divisions. The Board had explored a number of options to address the under performance and reached the conclusion that it was in the interests of all stakeholders of the Group to sell Haydon. This decision had been well communicated to our stakeholders over the period leading up to its disposal.

On 4 November 2013, the Company entered into an agreement to sell Haydon to a special purpose vehicle owned by the Haydon senior management team. Under the terms of the transaction, Mears sold the entire issued share capital of Haydon for a nominal consideration. In addition, Mears will receive a 50% share of any sales proceeds from a subsequent sale of Haydon, capped at £7.0m.

An intercompany loan of £9.0m owed to Mears by Haydon was left in place and on completion was converted into a £2.0m secured loan and a £7.0m working capital loan:

» the £2.0m loan is repayable immediately upon a subsequent sale of the business or, at the latest, the fifth anniversary of completion.

» a £7.0m working capital loan is repayable from working capital inflows in respect of a number of legacy contracts which had a recoverable sum at the time of the transaction together with a profit share on future profits. Any outstanding balance on this loan falls away on the fifth anniversary of completion.

Given the uncertainty as to the future outcome, the Board has taken a conservative stance in respect of the transaction. The anticipated recovery, based on management expectations, and the maximum recovery are detailed in the table below.

| | Maximum recovery | Anticipated recovery | Timing of anticipated recovery |
|---|---|---|---|
| Deferred consideration | £7.0m | £nil | — |
| Secured loan | £2.0m | £2.0m | 2018 |
| Working capital loan | £7.0m | £1.0m | 2014 |
| Corporation tax recoverable | £3.0m | £3.0m | 2014 |

As a result of the transaction, Mears incurred a loss on disposal of £18.5m. This loss is a non-cash item and is reflected within exceptional costs within the income statement. Based on the anticipated recovery, the transaction is expected to provide a cash upside of circa £4m within the next twelve months from a combination of payments received from Haydon and a tax benefit as a consequence of the transaction.

## Acquisition of ILS Group Limited (ILS)

In April 2013, Mears acquired the entire share capital of ILS, a leading homecare company operating solely in Scotland, for a total consideration of £22.5m on a debt-free, cash-free basis. ILS, with a large proportion of its work in higher acuity services, was an attractive addition to Mears' existing care proposition, improving Mears' offering in more complex homecare and developing the capability to offer longer-term continuing healthcare in the home, an area in which Mears did not currently operate.

The consideration represented a multiple of 7.8 times EBITDA against historic trading. To fund the acquisition, Mears issued 6.4m new ordinary shares at a price of 310p per share, raising a sum of £19.1 after the costs relating to the transaction. The balance of £3.4m was funded through our existing debt facility. ILS has performed well since the acquisition and is now fully integrated into the Mears Care business.

## Restatement of 2012

The adoption of IAS 19 'Employee Benefits' (revised) resulted in the restatement of the Income Statement and the Statement of Comprehensive Income. The most significant change to the Group's reported figures is that the expected returns on plan assets will no longer be recognised in profit or loss. Expected returns on pension fund assets are now replaced by recording interest income which is calculated using the discount rate used to measure the pension obligation. This has reduced the previously reported figures for operating profit, net finance charge and profit before tax by £0.4m, £2.3m and £2.6m respectively. The respective earnings per share measures for 2012 have been adjusted to reflect this restatement.

## Exceptional costs

Costs of £25.5m (2012: £2.9m) were considered to be non-recurring and exceptional in nature. Notably:

- the disposal of the non-core Mechanical & Electrical business resulted in a loss on disposal of £18.5m together with professional fees in respect of the disposal of £0.3m;
- the Group incurred integration and restructuring costs of £6.5m following the acquisition of Morrison Facilities Services Limited in late 2012. This brings the total exceptional costs expensed in respect of the Morrison integration to £8.5m. It is estimated that synergies have been realised amounting to in excess of £10.0m per annum. At the time of the transaction, the Board estimated final integration costs of £8.0m in order to unlock synergies of circa £8.0m per annum. The majority of the efficiencies were generated from the combination of the two support service functions. The costs incurred relate primarily to redundancy costs together with other non-recurring items; and
- the professional fees expensed in respect of the ILS acquisition amounted to £0.2m.

## Amortisation of acquisition intangibles

A charge for amortisation of acquisition intangibles of £10.9m (2012: £8.0m) arose in the period. This charge relates to a number of acquisitions in both Social Housing and Care over recent years. The increase in the period is principally driven from the acquisition of Morrison in late 2012 which created a balance of identified intangibles of £20.3m, the bulk of which will be amortised over a period of five years. The acquisition of ILS generated an identified intangible of £4.6m which is to be amortised over a period of three years.

## Net finance charge

A net finance charge of £1.8m has been recognised in the year (2012: £2.1m as restated).

The finance cost in respect of bank borrowings was £3.2m (2012: £2.7m). The increase is due to utilising debt to part-fund the acquisitions of Morrison in 2012 and ILS in 2013. The Group has previously entered into an interest rate swap which has fixed LIBOR of 1.95% on the first £55m of its borrowing. The remaining debt suffers a variable LIBOR rate that has been consistently in the region of 0.5% throughout the period. The Group pays a margin over and above the LIBOR which is subject to a ratchet mechanism but which is typically in the range of 1.5 to 2.0%.

The finance costs also include other interest of £0.40m (2012: £0.04m) relating to the discounting of trade receivables and provisions to properly reflect the time value of money.

# **Financial review** continued

## **Net finance charge** continued

The net finance income in respect of the defined benefit pension scheme was £1.7m (2012: £0.6m as restated). The increase reflects the increasing number of defined benefit pension schemes in which the Group is participating following the acquisition of Morrison, together with new contract start-ups.

## **Tax expense**

The tax charge for the year is £1.5m (2012: £0.9m). The large majority of this charge related to deferred tax. The current tax charge of £0.03m (2012: £4.4m) reflects the low profit for the year after accounting for the significant exceptional costs. The exceptional costs of £6.4m, relating to the restructure and integration of the Social Housing division following the acquisition of Morrison, are fully tax deductible. The Group will enjoy a tax deduction of around £13 million compared to the reported exceptional loss of £18.5 million following the disposal of Haydon. Given the disposal of Haydon took place at a late stage of 2013, the Group had already made quarterly instalment payments in respect of corporation tax for the 2013 year of £1.4m, the bulk of which will be recoverable in 2014.

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

## **Earnings per share (EPS)**

The normalised diluted EPS, which allows for the potential diluting impact of outstanding share options increased by 10% to 28.06p (2012: 25.60p). 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 23.3% (2012: 24.5%). 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.

| | **2013** **p** | 2012 p | Change % |
|---|---|---|---|
| Diluted (loss)/earnings per share | **(1.17)** | 18.85 | |
| Normalised diluted earnings per share* | **28.06** | 25.60 | +10% |
| Dividend per share | **8.80** | 8.00 | +10% |

* Before acquired intangible amortisation, exceptional costs and the initial trading loss (2012) of Morrison, with an adjustment to reflect a full tax charge.

## **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 final dividend of 6.30p per share which, combined with the interim dividend, gives a total dividend for the year of 8.80p (2012: 8.00p), a 10% increase. The dividend is payable on 3 July 2014 to shareholders on the register on 13 June 2014.

## **Cash performance**

| | **2013** **£m** | 2012 £m |
|---|---|---|
| Operating profit from continuing activities* | **41.1** | 32.8 |
| Operating profit from discontinued activities* | **(2.7)** | (1.6) |
| Exceptional costs with cash impact | **(8.8)** | (1.0) |
| Depreciation | **6.0** | 4.6 |
| EBITDA - all activities** | **35.6** | 34.8 |
| EBITDA - continuing** | **37.9** | 36.1 |
| Cash inflow from operating activities – all activities | **35.3** | 36.2 |
| Cash inflow from operating activities – continuing | **38.9** | 38.9 |
| EBITDA to cash conversion – all activities | **99%** | 105% |
| EBITDA to cash conversion – continuing | **103%** | 108% |
| Net debt at balance sheet date | **0.5** | 12.4 |
| Average debt in year*** | **70.0** | 75.0 |

* Before amortisation of acquisition intangibles and exceptional items.

** Before non-cash exceptional items.

*** Average debt in 2012 has been adjusted to reflect the debt funded acquisition of Morrison.

The efficiency with which the Group manages working capital remains a cornerstone of our business. The Group's conversion of EBITDA to cash in the period was 103% (2012: 108%). The Group has consistently set high standards of working capital management and high levels of conversion of profit into cash. The outcome for 2013 is particularly pleasing given the anticipated outflow following the relaxation in payments to Morrison suppliers.

Our net debt position at 31 December 2013 was £0.5m (2012: £12.4m). Whilst the year end cash position was pleasing, typically the accounting period end has a low debt balance when compared to the rest of the year. A far more important metric is the Group's daily net debt balances which provide a better indication of working capital management. The average net debt over the year showed a reduction to £70.0m compared to core debt in the previous year of £75.0m.

The Group has agreed a two year extension to its £120m unsecured revolving credit facility, with the new expiry date being July 2018. This also provided an opportunity to enjoy a small reduction in pricing together with increased flexibility. The Group continues to maintain a strong relationship with both its bankers, Barclays and HSBC.

## Balance sheet

| | 2013 £m | 2012 excluding M&E £m | 2012 Total £m |
|---|---|---|---|
| Goodwill and intangible assets | **193.6** | 177.7 | 177.7 |
| Property, plant and equipment | **15.1** | 15.5 | 16.0 |
| Inventories | **10.5** | 11.7 | 11.8 |
| Trade receivables | **151.6** | 154.1 | 183.1 |
| Trade payables | **(197.0)** | (192.5) | (213.1) |
| Net debt | **(0.4)** | (12.4) | (12.4) |
| Deferred consideration | **(1.8)** | (1.3) | (1.3) |
| Cash flow hedge | **(1.2)** | (2.5) | (2.5) |
| Pension (net of deferred tax) | **6.8** | 6.3 | 6.4 |
| Taxation | **3.0** | 3.3 | 3.1 |
| **Net assets** | **180.3** | 159.9 | 168.8 |

### Acquisitions and intangible assets

The value of goodwill and other identified intangibles carried within the balance sheet is £193.6m (2012: £177.7m). The significant increase during the period was due to the acquisition of ILS which created an intangible asset of £23.6m, together with the finalisation of the Morrison completion balance sheet.

A total of £10.9m (2012: £8.0m) of amortisation was charged to the Income Statement during the period.

### Other trading balances

The Group capital expenditure of £4.2m (2012: £3.9m) 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 £1.2m (2012: £1.1m).

Trade receivables and inventories decreased to £162.1m (2012: £165.8m on continuing activities). To register a decrease in trade receivables in a year that has seen solid organic growth and the acquisition of ILS is a tremendous achievement and has underpinned our terrific cash conversion statistics. Trade payables increased to £197.0m (2012: £192.5m on continuing activities) following the relaxation in the payment terms with the Morrison supply chain.

Total equity rose by £11.5m to £180.3m at 31 December 2013. The increase in net assets is driven by the issue of 2.4m shares on the exercise of share options and a further 6.4m shares to part-fund the acquisition of ILS. The full impact from these share issues on net assets was reduced by the reduction in retained earnings following the exceptional costs incurred in the year.

## Pensions

The Group participates in two principal Group pension schemes (2012: two) together with a further 30 (2012: 28) 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 significant pension scheme asset of £14.7m (2012: £14.0m) relates to the Morrison Facilities Services Limited defined benefit scheme. Whilst a small increase in the carrying value of the asset is pleasing, the scheme is the largest held by the Group and the Board is mindful that valuations can fluctuate. Importantly, based on the latest triennial valuation, dated April 2012, the scheme reported a surplus of £4.8m utilising a more prudent set of assumptions based on the statutory funding principles. The IAS 19 actuarial valuations for the other schemes as at December 2013 reported a small increase in the pension liability by £0.4m to £6.1m.

The Group continues to comply with a repayment plan agreed with the trustees of the Mears Group scheme which will see an increase in 2014 from £0.9m to £1.0m per annum for a period of seven years with a view to the scheme being fully funded by 2020.

| | 2013 £m | 2012 £m |
|---|---|---|
| Pension asset | **14.7** | 14.0 |
| Pension liability | **(6.1)** | (5.7) |
| **Net asset** | **8.6** | 8.3 |

**A C M Smith**
**Finance Director**
andrew.smith@mearsgroup.co.uk
28 March 2014

# Introduction to corporate governance

We seek to maintain the highest standards of corporate governance as this will help to facilitate the success of the Company and sustain this over time.

## Dear shareholder,

**At Mears, we seek to create a working culture where honesty, openness and fairness are valued.**

We seek to maintain the highest standards of corporate governance as this will help to facilitate the success of the Company and sustain this over time. An important distinction between the management, led by David Miles, Chief Executive Officer, is that they are responsible for running the business while the Board, acting under my leadership, provides the constructive challenge to the management necessary to create accountability and drive performance. This creates an environment that creates and preserves value for shareholders. The composition of the Board is vital to ensure that we have the right mix of skills and experience, ensuring that Board members have sufficient knowledge of the Company whilst maintaining their independence and objectivity.

**R Holt**
**Chairman**
bob.holt@mearsgroup.co.uk
28 March 2014

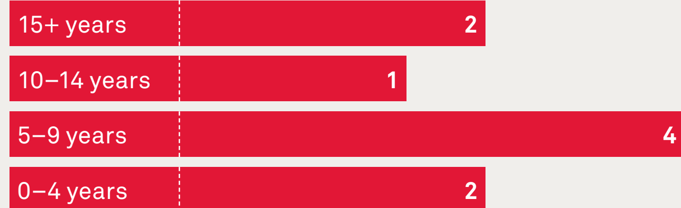
Read the Audit Committee Report on **pages 44 to 47**

Read the Nomination Committee Report on **page 43**

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

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

**Length of tenure of Board**




**Non-Executive/Executive Directors**

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**Bob Holt**
Chairman

Age: 59
Tenure: 18 years

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

**David J Miles**
Chief Executive Officer

Age: 48
Tenure: 18 years

Skills and experience: 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**
Finance Director

Age: 41
Tenure: 14 years

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

**Alan Long**
Executive Director

Age: 51
Tenure: 8 years

Skills and experience: Alan joined Mears in 2005 and, prior to his appointment to the Board in August 2009, he was Managing Director of 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**
Non-Executive Director

Age: 72
Tenure: 7 years

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

Board Committees: Remuneration Committee

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

Age: 71
Tenure: 6 years

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

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

**David L Hosein**
Non-Executive Director

Age: 50
Tenure: 6 years

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

Board Committees: Nomination Committee

**Davida Marston**
Non-Executive Director

Age: 60
Tenure: 3 years

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

Board Committees: Audit Committee (Chairman)

**Rory Macnamara**
Non-Executive Director

Age: 59
Tenure: 3 years

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

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

**Ben Westran**
Company Secretary

Age: 37
Tenure: 10 years

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

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# Corporate governance report

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

## Corporate governance framework

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

### Chairman, Bob Holt

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

Read more on governance on **pages 38 to 42**

### The Board

### Audit Committee

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

**Committee members**

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

Read the Audit Committee Report on **pages 44 to 47**

### Remuneration Committee

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

**Committee members**

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

Read the Remuneration Committee Report on **page 48**

### Nomination Committee

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

**Committee members**

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

Read the Nomination Committee Report on **page 43**

### Chief Executive Officer

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

Read the operational review on **pages 26 to 31**

### Senior Management Team

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

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## Introduction

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

## The Board of Directors

As at 31 December 2013, the Board had nine members comprising the Chairman, Chief Executive Officer, 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 page 37. These indicate the high level and range of business experience which enables the Group to be managed effectively. Their mix of skills and business experience is a major contribution to the proper functioning of the Board and its Committees, ensuring that matters are fully debated.

Read the Corporate Governance Report on **pages 38 to 42**

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

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

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

### Chairman

» Responsible for the leadership of the Board and ensuring its effectiveness

» Sets the Board's agenda and ensures adequate time is available for discussion of all agenda items

» Promotes a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors

» Ensures that the Directors receive accurate, timely and clear information

### Division of responsibilities

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

### Chief Executive Officer

» Manages the day-to-day business operations of the Group

» Ensures that the appropriate standards of corporate governance permeate throughout the organisation

» Recommends key strategies and implements those agreed by the Board

» Takes a leading role in the relationship with all external agencies and in promoting Mears Group PLC

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# Corporate governance report continued

## Board responsibility

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

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

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

## Independence of our Board

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

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

**Length of tenure**

| Director | |
|---|---|
| D L Hosein | 6 years |
| M G Rogers | 6 years |
| P F Dicks | 6 years |
| D Marston | 3 years |
| R Macnamara | 3 years |

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

- D L Hosein is a Director of OC&C Services Limited (OC&C). During the year, OC&C has received fees of £0.2m 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 Chief Executive Officer in a purely transactional role, focused on Careforce and not involved in the Group business, until 2008 when he became a Non-Executive Director of Mears; 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.

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

## Board membership and Board and Committee meeting attendance

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

## Board meetings

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

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### Board performance evaluation overview

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.

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 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.

### Board membership and Board and Committee meeting attendance

| | Board | | Audit | | Nomination | | Remuneration | |
|---|---|---|---|---|---|---|---|---|
| Number of meetings | Potential | Actual | Potential | Actual | Potential | Actual | Potential | Actual |
| R Holt | 6 | 6 | — | — | — | — | — | — |
| D J Miles | 6 | 6 | 4 | 4 | — | — | — | — |
| A C M Smith | 6 | 6 | 4 | 4 | — | — | — | — |
| A Long | 6 | 6 | — | — | — | — | — | — |
| M G Rogers | 6 | 6 | — | — | — | — | 3 | 3 |
| P F Dicks | 6 | 6 | 4 | 4 | 1 | 1 | 3 | 3 |
| D L Hosein | 6 | 6 | — | — | 1 | 1 | — | — |
| D Marston | 6 | 6 | 4 | 4 | — | — | — | — |
| R Macnamara | 6 | 6 | 4 | 4 | 1 | 1 | 3 | 3 |

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# Corporate governance report continued

## Evaluation of Board performance continued

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.

## 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.

## The Company and its shareholders

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

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

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

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

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

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

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

**P F Dicks**
**Senior Independent Non-Executive Director**
peter.dicks@mearsgroup.co.uk
28 March 2014

# Report of the Nomination Committee

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## Introduction

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

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

**R Macnamara**
**Nomination Committee Chairman**
rory.macnamara@mearsgroup.co.uk
28 March 2014

## Role of the Committee

The Nomination Committee's responsibilities include:

» keeping under review the composition of the Board and succession to it and succession planning for senior management positions within the Group;

» making recommendations to the Board concerning appointments to the Board, whether of Executive or Non-Executive Directors, having regard to the balance of skills, knowledge, experience and diversity of the Board;

» making recommendations to the Board concerning the re-appointment of any Non-Executive Director at the conclusion of his/her specified term and the re-election of any Director by shareholders under the retirement provisions of the Company's Articles of Association;

» managing a formal, rigorous and transparent procedure for any appointments of new Directors to the Board;

» prior to the appointment of a Director, requiring that the proposed appointee discloses any other business interests that may result in a conflict of interest and report any future business interests that could result in a conflict of interest; and

» ensuring that, on appointment to the Board, Non-Executive Directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, Committee service and involvement outside of Board meetings.

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 plan.

# Report of the Audit Committee

## Introduction

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

This has been a busy year for the Audit Committee. In line with best practice, the appointment of the external auditors was tendered to coincide with the mandatory rotation of the Grant Thornton audit partner. The tender process resulted in their re-appointment.

In recent years a considerable focus has been placed on risk governance and the effectiveness of management oversight of both risk and internal controls. At the end of the year the Audit Committee and management commissioned an external review of both areas which recognised the excellent work undertaken and made some recommendations to assist management with strengthening and enhancing the risk management and internal audit function. The Committee reviewed the financial reporting impact of a full trading year since the acquisition of Morrison.

**D Marston**
**Audit Committee Chairman**
davida.marston@mearsgroup.co.uk
28 March 2014

## Role of the Committee

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

The Audit Committee is responsible for:

» reviewing and recommending for approval by the Board the annual and interim financial statements;

» agreeing the scope and reviewing the results of the external audit and the setting of the auditor's remuneration;

» reviewing the effectiveness of the Group's internal controls and risk management processes;

» approving the internal audit plan and monitoring the effectiveness of the internal audit function; and

» reviewing the 'Whistleblowing policy' by which employees and other stakeholders may raise concerns regarding potential impropriety in confidence and ensure that these concerns are investigated appropriately.

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

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

## Committee meetings

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

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## Main activities of the Committee during the year

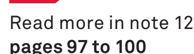
### Financial reporting

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

The primary areas of judgement considered by the Committee in relation to the 2013 accounts, and how these were addressed, were:

#### Impairment of goodwill

For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows; if these are termed as cash-generating units (CGUs). Mears has identified two CGUs, being Social Housing and Care. Determining whether goodwill is impaired requires an estimate of the value in use of each of the cash-generating units (CGUs) to which goodwill has been allocated. The value-in-use calculation involves an estimate of the future cash flows of the CGU and also the selection of an appropriate discount rate to calculate present values. Future cash flows are estimated using the current one-year budget, extrapolated for five years using specific rates with a general terminal growth rate being used thereafter. Estimated growth rates over each period are based on past experience and knowledge of the individual sector's markets. The Directors consider that the estimates and judgements involved in determining the value in use of the Care CGU goodwill are the most significant to the Group and they have therefore utilised the services of an external consultant to assist with this impairment review. The value in use is most sensitive to changes in the terminal growth rate, the explicit growth rate during the forecast period and the discount rate. The sensitivity to changes in these estimations is detailed in note 12.



Read more in note 12
**pages 97 to 100**

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

- the Committee reviewed the key assumptions proposed by management, notably forecast growth rate and discount rate. Given the importance of these two assumptions, the Committee reviewed reports prepared by a third party valuation expert, American Appraisal, which provided validation to the management proposals;
- the Committee reviewed the asset valuation report prepared by American Appraisal on behalf of management. The Committee gave particular focus to the sensitivity analysis which showed the level of changes in key assumptions that would be required before triggering any impairment; and
- this area represented a prime area of audit focus and Grant Thornton provided detailed feedback to the Committee.

#### Defined benefit liabilities

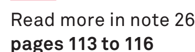
A number of key estimates have been made, which are given below and which are largely dependent on factors outside the control of the Group:

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

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

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

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



Read more in note 26
**pages 113 to 116**

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

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

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# Report of the Audit Committee continued

## Main activities of the Committee during the year continued

**Financial reporting** continued

Revenue recognition

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

» the amount of revenue can be measured reliably;

» it is probable that the economic benefits associated with the transaction will flow to the entity;

» the stage of completion of the transaction at the balance sheet date can be measured reliably; and

» the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

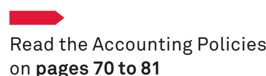
Full provision is made for losses on all contracts in the year in which the loss is first foreseen.

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

» the Committee reviewed the key judgements report prepared by management which provided a detailed explanation in respect of the valuation of unbilled works and the recognition of revenues;

» the Committee took comfort from the contract management system which is central in generating the valuation of works (both billed and unbilled) and the integrated process that is followed to ensure an accurate cut-off to that revenue is appropriately matched to cost. Grant Thornton tested these systems during its audit fieldwork and provided feedback to the Committee on this crucial area; and

» this area represented a prime area of audit focus and Grant Thornton carried out substantive testing on around 75% of the amounts recoverable on contracts (by value) and provided detailed feedback to the Committee in this area.



Read the Accounting Policies on **pages 70 to 81**

### Internal control and risk management

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

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

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

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

» delegation of day-to-day management to operational management within clearly defined systems of control, including:

  » the identification of levels of authority within clearly identified organisational reporting structures;

  » the identification and appraisal of financial risks both formally, within the annual process of preparing business plans and budgets, and informally, through close monitoring of operations;

  » a comprehensive financial reporting system within which actual results are compared with approved budgets, quarterly re-forecasts and previous years' figures on a monthly basis and reviewed at both local and Group level; and

  » an investment evaluation procedure to ensure an appropriate level of approval for all capital and revenue expenditure;

» discussion and approval by the Board of the Group's strategic directions, plans and objectives and the risks to achieving them, combined with regular reviews by management of the risks to achieving objectives and actions being taken to mitigate them;

» review and approval by the Board of annual budgets, combined with regular operational and financial reviews of performance against budget, prior year results and regular forecasts by management and the Board;

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## Main activities of the Committee during the year continued

**Internal control and risk management** continued

- 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:

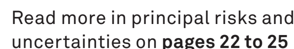
- a defined organisational structure and an appropriate level of delegated responsibility to operational management;
- authorisation limits for financial and non-financial transactions;
- written operational procedures;
- a robust system of financial budgeting and forecasting;
- a robust system of financial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

During 2013, the Audit Committee commissioned an independent review of internal audit and our risk management to provide guidance as to the strengths and weaknesses of the function and also identify and recommend changes and pragmatic action plans to improve its effectiveness.

Grant Thornton was appointed to carry out this review and utilise its first-hand knowledge from working with the internal audit functions of groups of various sizes operating in a diverse range of markets. The Group's internal audit function was benchmarked on a range of KPIs to identify where performance could be improved. The review considered issues including audit planning and delivery methodologies, the capabilities of the team and the outputs provided to management and the Board.

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

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



Read more in principal risks and uncertainties on **pages 22 to 25**

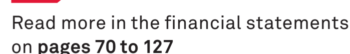
Additionally, in line with the UK Corporate Governance Code, the Group has arranged appropriate insurance cover in respect of legal action against its Directors.

## External audit-related services

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

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

The fees paid to Grant Thornton during the year in respect of non-audit services were £0.08m (2012: £0.04m). The total fees for non-audit services represented approximately 22% of the audit fees paid for the year (2012: 12%).



Read more in the financial statements on **pages 70 to 127**

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# Report of the Remuneration Committee

## Dear shareholder,

**I am pleased to introduce the Mears 2013 Remuneration Report. During the 2013 financial year we have continued to see a focus on Executive remuneration. In line with the revised remuneration disclosure regulations that came into force in 2013, we have split the report into two parts:**

- the Directors' Remuneration Policy Report sets out the Company's remuneration policy for Directors for three years from the date of the 2014 AGM and the key factors that were taken into account in setting the policy. This policy is subject to a binding shareholder vote at the 2014 AGM and after that at least every third year; and
- the Annual Report on Remuneration sets out payments and awards made to the Directors and details the link between Company performance and remuneration for the 2013 financial year. This report together with this letter is subject to an advisory shareholder vote at the 2014 AGM.

In 2013, we undertook a comprehensive review of the remuneration arrangements for our Executive Directors. It is our desire that pay and benefits reflect our aspirations as a Company and they must be at a level that will attract and retain high quality management who are fully incentivised to deliver outstanding performance. We operate in a highly challenging market that places a significant premium on successful individuals and we have, in our Executive Directors, individuals of proven ability. However, we were concerned that the pre-existing remuneration arrangements were not as closely aligned to our business strategy as they might have been and so not operating as an effective mechanism to deliver our objectives.

The outcome of our review was the introduction of a new incentive arrangement (the Management Incentive Plan or "MIP") to replace the annual bonus and long-term incentive plan along with a "one-off" share award to compensate them for LTIP awards which we were unable to grant in 2011 and 2012. Under the MIP, there is a far greater emphasis on linking executive reward with performance against significant KPIs. Further details of these arrangements are contained in this report. Shareholders approved these arrangements at a general meeting in June this year.

This year has been another successful year for the Company with significant progress made in both core divisions. The highlights of the year were:

- the acquisition of Morrison completed late in 2012 and the first half of 2013 saw an intense period of integration and business improvements to turn a loss making business into a profitable entity;
- the acquisition of ILS which enhances our higher acuity care offering;
- disposal of the Mechanical & Electrical Services division;
- revenue increased by 32%;
- EBITA to cash conversion at 113%;
- an order book of £3.8 billion (2012: £3.8 billion) with a solid pipeline of new opportunities;
- return on capital employed of 19%; and
- delivered shareholder return of 44% for the year.

Against this background and given that actual performance against the corporate targets (EPS, total shareholder return, cash conversion and ROCE) was at the "stretch" end of our expectations, the annual contribution under the MIP for the year ended 31 December 2013 was determined to be 250% of salary. Part of this will be paid in cash with the balance delivered in shares which will be released over a period of five years. The Remuneration Committee was also comfortable that these bonus payments were justifiable in the context of the overall performance and financial health of the Company.

We believe that for the future, the new incentive structure will forge a strong link between remuneration and our strategic objectives. It should also give us the ability to recruit and retain employees of exceptional talent. In addition, the new incentive structure is designed to be compliant with best practice corporate governance and sustainability of strong corporate performance over the longer term. This focus on incentive pay for performance is also emphasized by our decision to maintain base salaries at the current level for another year.

We believe that the changes we made to the structure remain relevant for the next three years and we look to shareholders to approve the report.

**P F Dicks**
**Remuneration Committee Chairman**
peter.dicks@mearsgroup.co.uk
28 March 2014

# Remuneration report

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## Directors' remuneration policy

### Remuneration policy and philosophy

| Remuneration policy | How is this achieved? |
|---|---|
| Levels of remuneration should be appropriate to retain and motivate the Executive talent required to meet the Group's objectives. | » 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 Mears' remuneration policy and external benchmarks and market practices. |
| Incentive arrangements for key individuals should be capable of providing exceptional levels of total payment if outstanding performance is achieved. | » The Executive Directors' remuneration packages are designed to ensure that variable components of an Executive Director's total remuneration package amounts to around one half for target performance and around two thirds for stretching performance. |
| The significant component of each Executive's total compensation should be delivered through performance related pay. | » Around half of the Executive Directors' total remuneration package is based on performance related pay. |
| 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. |

### Executive Directors

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

| Objective and link to strategy | Operation | Maximum opportunity | Performance measures and assessment |
|---|---|---|---|
| **Base salary** | | | |
| The purpose of the base salary is to:<br>» help recruit and retain key individuals;<br>» reflect the individual's experience, role and contribution within the Group; and<br>» ensure fair reward for 'doing the job'. | The Committee reviews base salaries annually in April in order to ensure that Executive Directors remain competitively aligned with external market rates.<br>The Committee will retain the discretion to increase an individual's salary where there is a significant difference between current levels and a market competitive rate. However, in determining whether to increase levels the Committee will take the following into consideration:<br>» the performance of the individual Executive Director;<br>» the individual Executive Director's experience and responsibilities;<br>» the impact on fixed costs of any increase; and<br>» pay and conditions throughout the Group.<br>When setting the salary levels for the Executive Directors, in addition to the factors summarised above, salary levels paid by a number of comparator companies of a similar size to Mears are taken into account. | The Committee's policy is to set base salary at an appropriate level taking into account the factors outlined in this table.<br>The Committee would anticipate annual increases to be in line with staff increases across the Group. | Not applicable. |
| **Other benefits** | | | |
| To provide benefits that are valued by the recipient and are appropriately competitive. | The Executive Directors receive additional benefits including a company provided car or an allowance in lieu, life assurance and private medical insurance. Benefits-in-kind are not pensionable. | Benefit values vary year-on-year depending on premiums and the maximum potential value is the cost of these provisions. | Not applicable. |

# Remuneration report continued

## Directors' remuneration policy continued

### Executive Directors continued

| Objective and link to strategy | Operation | Maximum opportunity | Performance measures and assessment |
|---|---|---|---|
| **Management Incentive Plan (MIP)** | | | |
| The MIP provides a strong link between reward and corporate performance in order to appropriately retain and motivate the Executive Directors and senior management who are critical to executing the business strategy.<br><br>Align the interests of Executive Directors and senior management more closely with shareholders over the longer term and provide a greater exposure to share price movements over this period. | » Participants will have a plan account into which contributions by Mears are made.<br>» Performance will be measured by reference to targets over the financial year.<br>» Contributions will then be made annually with payments made each year to ensure an overlap with the next plan year depending on the extent to which the performance conditions are met.<br>» After contributions are made, 50% of the plan balance is paid in cash and 50% is deferred in shares.<br>» No contribution will be made to a participant's plan account unless the performance conditions and financial underpins set at the beginning of the relevant year are satisfied. Where only one of the financial underpins is met and the performance conditions are met then the annual contribution will be reduced by 50%.<br>» 50% of the plan account will be at risk of forfeiture each year if minimum level of performance is not met.<br>» Further details of the operation of the MIP including the performance conditions for 2013 are set out on page 62. | Annual contributions made to Executive Directors will be capped at a maximum of 250% of salary.<br><br>Threshold payments will be at 40% of an Executive Director's maximum opportunity. | Contributions will be based on the satisfaction of performance conditions, for example EPS and TSR. The Remuneration Committee has discretion to set performance measures and weightings on an annual basis, with performance conditions for the next financial year set out in the Statement of Implementation on pages 62 to 63. |
| **Share Plan** | | | |
| The Share Plan serves to align the interests of Executives and shareholders. | Under the Share Plan, awards will be granted in the form of options. | Value of awards granted will be up to 200% salary for the Executive Directors and senior management. Any future awards will be subject to a five-year vesting period and satisfaction of performance conditions where applicable. Although new joiners may participate in this award, the existing Executive Directors will not do so as long as they are participating in the MIP. | Vesting will not be subject to performance conditions. The Share Award has been designed to address the fact that no LTIP awards have been granted in 2011 or 2012 and in recognition of the performance levels which have been achieved over the past three years. Under the LTIP, the policy has been to grant annual awards of 200% salary. The proposed Share Award level of 200% of salary for the Executive Directors reflects the expected value of the LTIP awards that would have been granted in 2011 and 2012 (400% in total) taking into account corporate performance levels to date. |

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## Directors' remuneration policy continued

### Executive Directors continued

| Objective and link to strategy | Operation | Maximum opportunity | Performance measures and assessment |
|---|---|---|---|
| **Pension** | | | |
| To provide a framework to save for retirement that is appropriately competitive. | All Executive Directors receive a contribution into their respective defined contribution plans which are subject to periodic review to ensure that they remain in line with rates applicable in the market. Only the base salary is pensionable.` | The Executive Directors receive a contribution of 15% of salary. R Holt receives a contribution of 30% of salary. | Not applicable. |
| **All employee share plan** | | | |
| Encourages employee to own shares in order to increase alignment over the longer term. | Under the terms of the Sharesave Plan all employees can apply for three or five-year options to acquire the Company's shares priced at a discount of up to 20%. | £250 per month over a three year or five year period. | Not applicable. |
| **Provisions of previous policy that will continue to apply** | | | |
| Previous LTIP. | Awards granted prior to 1 January 2013 under the LTIP remain outstanding. The last issue awarded under this scheme part-vested during 2013 and may be exercised in accordance with the terms of the LTIP as previously approved by shareholders.<br><br>The Committee's policy has been to provide market competitive annual share grants to Executive Directors and certain members of the Senior Management Team.<br><br>Two performance conditions, EPS and TSR, were measured independently. Awards have been released on the third anniversary of the date of grant subject to the achievement of the relevant performance conditions over the same period. | 200% of salary p.a. | 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. 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. |
| Other Non-Executive appointments. | Executive Directors have an obligation to inform the Board, specifically the Remuneration Committee, of any Non-Executive positions held or being contemplated and of the associated remuneration package. The Remuneration Committee will consider the merits of each case and carefully consider the work and time commitment required to fulfil the Non-Executive duties and the potential benefit to the Group and then determine whether the remuneration should be retained by the Executive or passed over to the Group. | Not applicable. | Not applicable. |

# Remuneration report continued

## Directors' remuneration policy continued

### Notes to the future policy table

#### Changes to remuneration policy from previous policy

The Mears Remuneration Committee reviewed the previous policy's current incentive arrangements for the Company's Executive and other senior managers and identified the need for a new structure which:

- » better reflects the Group's future business strategy;
- » provides a stronger link between reward and corporate performance in order to appropriately retain and motivate the Executive Directors and senior management who are critical to executing the business strategy;
- » incorporates a more flexible and strategically aligned performance metrics;
- » provides a simplified and clearly understood structure which all stakeholders should understand with an appropriate probability of payout; and
- » aligns the interests of shareholders, Executive Directors and senior management more closely over the longer term by providing a greater exposure to share price movements.

#### Reasons for selecting performance targets

The Committee believes that the EPS growth performance condition for the MIP is directly aligned to the Company's strategic objectives over the long term and is also transparent, fully understood by participants and is an externally audited metric over which they have line of sight. Total shareholder return has been selected as a performance condition for the MIP as it provides an unbiased indicator of value created for shareholders and creates a strong link with executive reward. Targets are set on a sliding scale based on internal growth expectations of the Company and market forecasts. Maximum targets are believed to incorporate an appropriate amount of stretch which would reflect excellent performance in current market conditions. Two financial underpins, based on threshold levels of cash conversion and return on capital employed have also been set for 2013 which impact the level of contribution under the EPS performance condition. Given that no contribution will be made in respect of the EPS condition unless these underpins are achieved, this ensures that the quality of earnings is protected and overall corporate performance is strong before a contribution to the plan accounts is made.

For 2014 and onwards, where there are multiple underpins, failure to achieve one of the underpins will result in a reduction of the annual contribution by a relevant proportion. For example, if there are two underpins and one is not met then the annual contribution will be reduced by 50%. If both underpins are not met then there will be no annual contribution.

#### Differences in remuneration policy for all employees

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

The revised incentive structure delivers an appropriate mix of cash and shares dependent on financial and strategic performance and will be subject to both forfeiture and a longer holding period than the previous arrangement. This approach will ensure that strong year-on-year corporate performance is rewarded. The primary focus on annual performance will also ensure that the Committee retains the flexibility to select targets which drive shareholder value in a highly uncertain and challenging economic and business environment.

As a result, the previous incentive structure which comprised 75% of salary annual bonus opportunity and 200% of salary annual long-term incentive (LTIP) Award has been replaced with a new structure, the MIP. The terms of the MIP are as follows:

- » a maximum annual contribution of 250% of salary can be paid into an Executive Director's plan account based on the satisfaction of performance conditions and financial underpins;
- » the MIP will operate over a period of five financial years;
- » there will be an entitlement to an annual payment of 50% of the balance of the plan account (with the priority being a cash payment) with the remainder being deferred in shares and paid out over the plan period;
- » 50% of the plan account will be at risk of forfeiture each year if a minimum level of corporate performance is not met; and
- » on the fifth anniversary of the start of the plan, the balance of participants' accounts will be paid.

In addition, an award of shares of 200% of salary was made to Executive Directors to reflect:

- » the historic misalignment between the Group's long-term strategic and financial performance and the actual rewards earned by Executive Directors and management;
- » the fact that no LTIP awards have been granted in 2011 or 2012, coupled with the reduced quantum under the MIP; and
- » the Executive Directors and senior management retention risk created by the disconnect between reward and performance.

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## Directors' remuneration policy continued

**Notes to the future policy table** continued

Changes to remuneration policy from previous policy continued

The table below summarises how the revisions to the incentive plan fulfil the Committee's objectives:

| Objectives | Design element |
|---|---|
| Better reflect the Group's future business strategy. | » Ability to set annual performance conditions under the MIP which reflect business focus and strategy in a volatile market. |
| Provide a stronger link between reward and corporate performance in order to appropriately retain and motivate the Executive Directors and senior management who are critical to executing the business strategy. | » Grant of initial share award based on historic performance.<br>» Initial share award reflects historic disconnect between reward and strategic performance and strengthens the link.<br>» Lock-in provided through deferral of payments earned under the MIP over a five-year period. |
| Incorporate more flexible and strategically aligned performance metrics. | » Ability to set a variety of annual performance targets linked to achievement of Group KPIs, personal and other targets. |
| A simplified and clearly understood structure with an appropriate probability of payout. | » The existing 75% of salary bonus and 200% LTIP will be combined into one incentive arrangement of 250% under the MIP to be delivered in a mixture of cash and shares.<br>» Shares will be subject to forfeiture and a longer holding period. |
| Align the interests of Executive Directors and senior management more closely over the longer term and provide a greater exposure to share price movements over this period. | » Payments under the MIP are earned over a five-year period.<br>» Increased portion of reward being delivered in shares rather than cash through the MIP, thus increasing strength of alignment with shareholders.<br>» Long-term sustainable performance promoted through forfeiture condition imposed under the MIP. |

### Committee discretions

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

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

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

### Non-Executive Directors

The remuneration of the Non-Executive Directors is set at a level sufficient to attract individuals with appropriate knowledge and experience. It is determined by the Board and is within the limits set by the Articles of Association. Assistance is also available from the Group's remuneration advisers. No additional fees are paid for Committee membership or other normal duties and Non-Executive Directors do not participate in any incentive, pension or bonus arrangements. Current fee levels are set out in the statement of implementation of remuneration policy on page 62.

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# Remuneration report continued

## Directors' remuneration policy continued

### Approach to recruitment remuneration

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

The Committee would generally seek to align the remuneration of any new Executive Director following the same principles as for the current Executive Directors (set out in the table on page 49).

The elements that would be considered by the Company for inclusion in the remuneration package for a new Director are in line with those offered to existing Directors (see policy table on page 49 for more details):

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

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

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

### Service contracts and payment for loss of office

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

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

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

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

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

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

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

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

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## Directors' remuneration policy continued

### Illustrations of application of remuneration policy

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

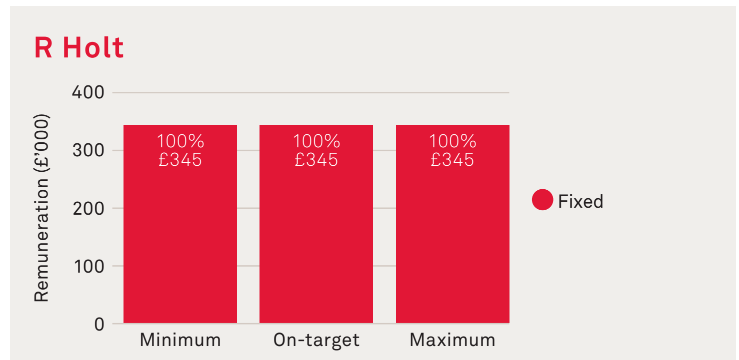
» minimum performance is where only fixed pay (salary, benefits and pension) is payable and no performance related pay accrues;

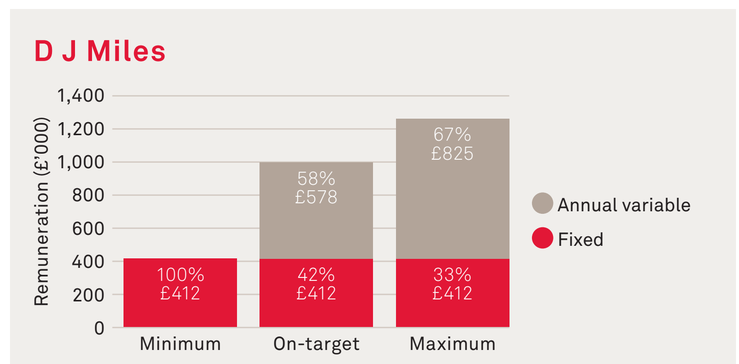
» on-target performance is the level of performance required to deliver 70% of the maximum annual contribution to the MIP; and

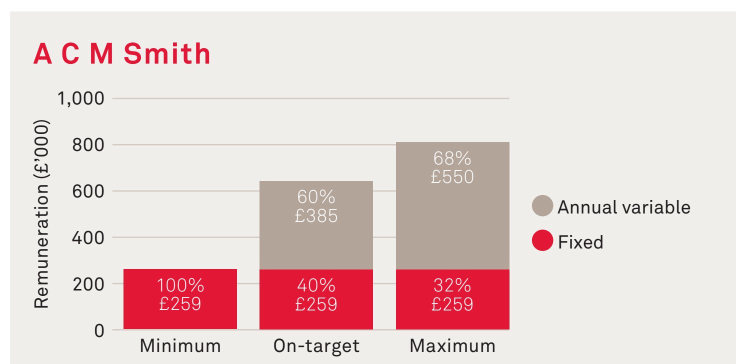
» maximum performance would result in the maximum annual bonus contribution to the MIP.

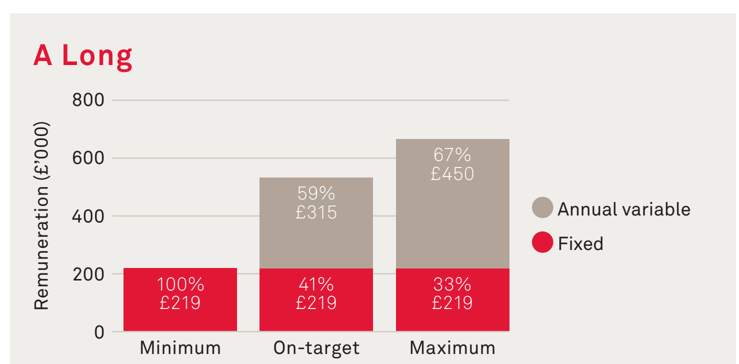
Fixed salary is base salary for 2014 plus the value of pension and other benefits.

The charts to the right demonstrate the balance between fixed and variable pay for minimum, on-target and maximum performance for Executive Directors' remuneration in 2014 in line with the relevant policy.




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

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

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

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

### Consideration of shareholder views

The Committee is committed to an ongoing dialogue with shareholders and seeks shareholder views when any significant changes are being made to remuneration arrangements. We remain sensitive to the views of shareholders and sought to consult many of our largest shareholders during the changes we made to the remuneration structure. We explained the rationale for our actions in 2013 and can reassure shareholders there will be no changes to the remuneration structure for the next three years. The Committee will continue to monitor shareholder comments and retain an open dialogue as necessary.

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# Remuneration report continued

## Annual report on remuneration

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

### Single total figure of remuneration (audited)

Executive Directors

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

| Executive Director (£'000) | Year | Salary | Taxable benefits | Annual incentives | Pension | Total |
|---|---|---|---|---|---|---|
| R Holt | 2013 | 250 | 20 | — | 75 | 345 |
| | 2012 | 250 | 20 | — | 75 | 345 |
| D J Miles | 2013 | 330 | 32 | 413 | 50 | 825 |
| | 2012 | 330 | 29 | — | 50 | 409 |
| A C M Smith | 2013 | 220 | 6 | 275 | 33 | 534 |
| | 2012 | 220 | 6 | — | 33 | 259 |
| A Long | 2013 | 180 | 12 | 225 | 27 | 444 |
| | 2012 | 180 | 11 | — | 27 | 218 |

Non-Executive Directors

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

| Non-Executive Director (£'000) | Year | Basic fees | Additional fees | Other | Total fees |
|---|---|---|---|---|---|
| D L Hosein | 2013 | 45 | — | — | 45 |
| | 2012 | 45 | — | — | 45 |
| M G Rogers | 2013 | 45 | — | 2 | 47 |
| | 2012 | 45 | — | — | 45 |
| P F Dicks | 2013 | 45 | — | — | 45 |
| | 2012 | 45 | — | — | 45 |
| D Marston | 2013 | 45 | — | — | 45 |
| | 2012 | 45 | — | — | 45 |
| R Macnamara | 2013 | 45 | — | — | 45 |
| | 2012 | 45 | — | — | 45 |

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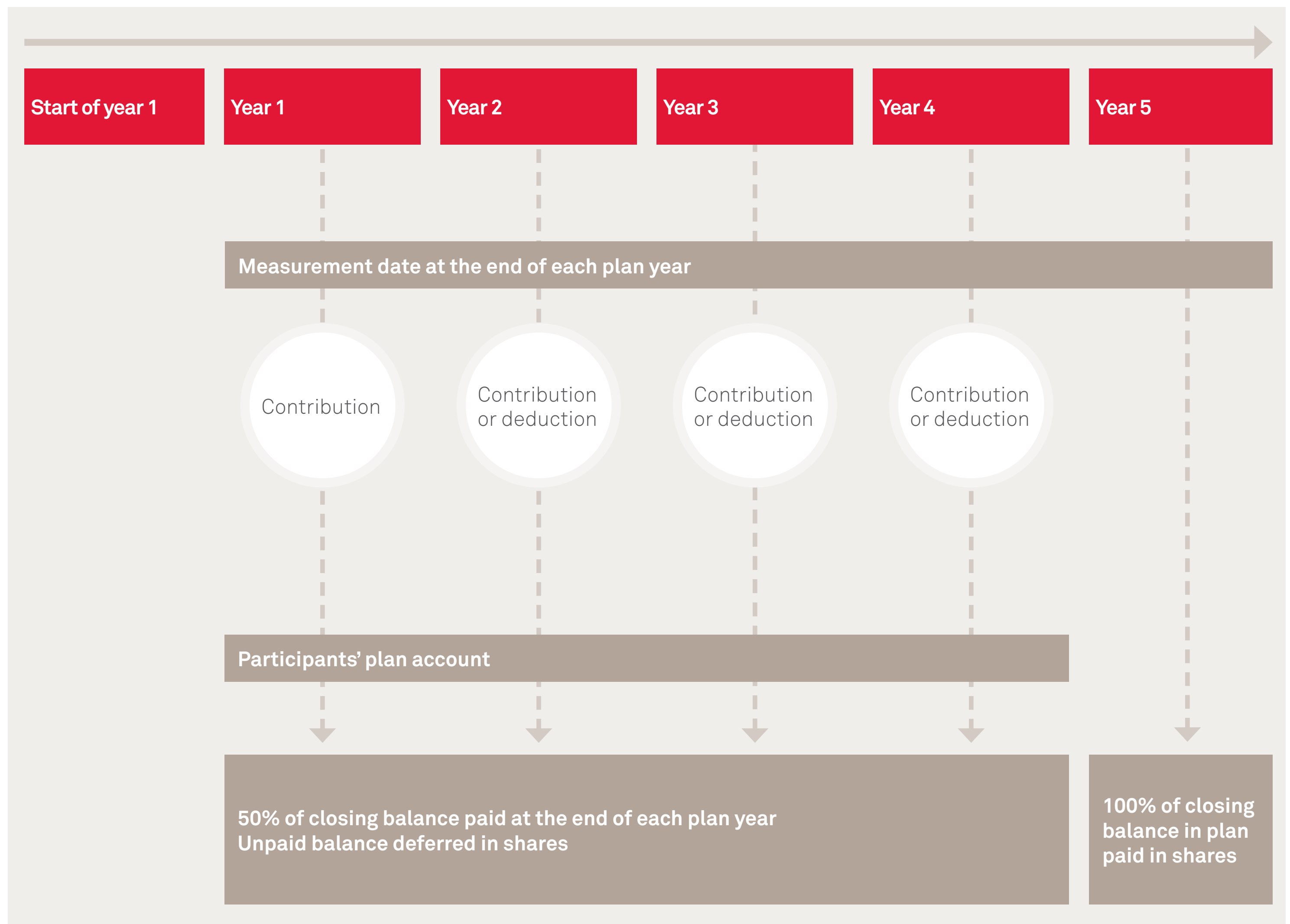
## Annual report on remuneration continued

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

Outcome of the MIP for the year ended 31 December 2013, being year one on the schematic below. The following schematic illustrates the operation of one cycle of the MIP:



# Remuneration report continued

## Annual report on remuneration continued

The performance measures and targets for the MIP for the year ending 31 December 2013 are detailed below:

| Description | Weighting | Calculation | Targets |
|---|---|---|---|
| Earnings per share (EPS). | 80% | » Growth in diluted EPS. Diluted EPS is stated before exceptional costs, share-based payments and the costs relating to the MIP and amortisation of acquisition intangibles and is adjusted for a normalised tax charge from 1 January 2013 to 31 December 2013.<br>» Base figure of 24.12p to be used. | » EPS measure contributes 80% of maximum annual contribution.<br>» EPS growth of less than 10% will deliver no EPS contribution.<br>» EPS growth of 10% will deliver 70% of an individual's EPS contribution.<br>» EPS growth of 15% will deliver 100% of an individual's EPS contribution.<br>» Straight-line vesting between points. |
| Absolute Total Shareholder Return (TSR). | 20% | » Growth in absolute TSR from 1 January 2013 to 31 December 2013 (using an averaging period of 30 days for both dates). | » TSR measure contributes 20% of maximum annual contribution.<br>» TSR of less than 8% will deliver no TSR contribution.<br>» TSR of 8% will deliver 28% of an individual's TSR contribution.<br>» TSR of 9% will deliver 70% of an individual's TSR contribution.<br>» TSR of 15% will deliver 100% of an individual's TSR contribution.<br>» Straight-line vesting between the 9% and 15% points. |
| Cash conversion (underpin). | N/A | » Cash inflow from operating activities as a proportion of operating profit before acquisition intangible amortisation measured at 31 December 2013. | » A threshold level of cash conversion of 80% must be achieved.<br>» If this threshold level is not achieved, no contribution will be made to the plan account in respect of the EPS condition regardless of the level of EPS growth achieved. |
| Return on capital employed (ROCE) (underpin). | N/A | » Operating profit before acquisition intangible amortisation and exceptional costs/(total assets – current liabilities less all balances relating to bank borrowing and overdraft classified within non-current liabilities) at 31 December 2013. | » A threshold level of ROCE of 10% must be achieved.<br>» If this threshold level is not achieved, no contribution will be made to the plan account in respect of the EPS condition regardless of the level of EPS growth achieved. |

The actual performance achievement is summarised below:

| Performance measures | Actual | % of target satisfied |
|---|---|---|
| EPS growth | 23% | 100% |
| TSR growth | 44% | 100% |
| Cash conversion (underpin) | 113% | Achieved |
| ROCE (underpin) | 19% | Achieved |

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## Annual report on remuneration continued

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

| | D J Miles | A C M Smith | A Long |
|---|---|---|---|
| 2013 opening balance of participants plan account | — | — | — |
| 2013 contribution* | £825,000 | £550,000 | £450,000 |
| (% of salary) | 250% | 250% | 250% |
| 2013 cash element released | £412,500 | £275,000 | £225,000 |
| 2013 closing balance (deferred into shares) of participants plan account | £412,500 | £275,000 | £225,000 |
| Number of shares represented by closing balance** | 90,065 | 60,043 | 49,126 |

* See above for the 2013 performance conditions and their level of satisfaction.
** Determined by closing average share price as at 31 December 2013 of £4.58.

### Long-term incentives

The LTIP was approved by shareholders in October 2008. Awards made under this plan in 2010 matured in 2013. The performance measures applicable and extent to which the performance measures have been satisfied have been assessed by the Committee with the following results:

| | D J Miles | A C M Smith | A Long |
|---|---|---|---|
| Award | 200% of base salary. | | |
| Performance measures and weighting | 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. 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. | | |
| Performance targets | The performance applicable to 2010 awards is subject to EPS growth 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 where 30% vests for performance equal to the Index and full vesting occurs for outperforming the Index by 10%. | | |
| Actual performance outcome | The EPS growth was 9.5% over the vesting period, resulting in 19% of options vesting. The TSR growth was 3.9% higher than the benchmark over the vesting period, resulting in 14% of options vesting. An aggregate of 33% of awards made vested and are capable of exercise. | | |
| Number of awards granted | 170,000 | 130,000 | 100,000 |
| Number of awards vesting | 56,100 | 42,900 | 33,000 |
| Value of vested awards £* | 151,470 | 115,830 | 89,100 |

* Value of vested awards are stated before income taxes. The value also excludes the reimbursement to the Company by the employee for Employers' National Insurance contribution at the point of exercise.

### Scheme interests awarded in financial year (audited)

The table below sets out the details of the long-term incentive awards granted under the Share Plan in the financial year:

| Executive Director | Basis of award | Face value of award made* | Number of awards | End of performance period | Exercise price |
|---|---|---|---|---|---|
| D J Miles | 200% of salary | £660,000 | 203,367 | 1 January 2016 | 1p |
| A C M Smith | 200% of salary | £440,000 | 135,578 | 1 January 2016 | 1p |
| A Long | 200% of salary | £360,000 | 110,927 | 1 January 2016 | 1p |

* The face value of the award was set by reference to the average of the closing share prices over the 30-day period prior to 1 January 2013, being 324.5p per share.

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# Remuneration report continued

## Annual report on remuneration continued

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

Directors' share interests are set out below:

| Director | Number of beneficially owned shares | Share interests: Conditional unvested Share awards/ options | Share interests: Vested but unexercised Options | Total interests held at year end |
|---|---|---|---|---|
| R Holt | — | — | 150,000 | 150,000 |
| D J Miles | 175,020 | 293,432 | 60,730 | 439,117 |
| A C M Smith | 105,000 | 195,621 | 72,967 | 313,545 |
| A Long | 66,230 | 160,053 | 42,088 | 219,245 |
| D L Hosein | — | — | — | — |
| M G Rogers | 50,000 | — | — | 50,000 |
| P F Dicks | 23,298 | — | — | 23,298 |
| D Marston | 15,342 | — | — | 15,342 |
| R Macnamara | — | — | — | — |

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

| Date of grant | Type of award | Exercised during year | Exercise price of exercised options p | Market value of exercise p | Gain on exercise £* |
|---|---|---|---|---|---|
| **R Holt** | | | | | |
| 28 September 2009 | SIP | 850,000 | 1 | 413 | 3,513,250 |
| **D J Miles** | | | | | |
| 1 April 2004 | Unapproved | 30,453 | 1 | 387 | 117,550 |
| 8 April 2005 | Unapproved | 7,220 | 1 | 387 | 27,869 |
| 21 April 2006 | Approved | 10,000 | 300 | 387 | 8,700 |
| 21 April 2006 | Unapproved | 6,087 | 1 | 387 | 23,496 |
| 28 September 2007 | Unapproved | 50,045 | 1 | 387 | 193,172 |
| 20 March 2008 | Unapproved | 151,149 | 1 | 387 | 583,437 |
| 13 October 2008 | LTIP | 26,550 | 1 | 387 | 102,483 |
| 28 October 2009 | LTIP | 11,000 | 1 | 387 | 42,460 |
| **A Long** | | | | | |
| 21 April 2006 | Approved | 10,000 | 300 | 387 | 8,700 |
| 21 April 2006 | Unapproved | 6,087 | 1 | 387 | 23,496 |
| 28 September 2007 | Unapproved | 20,018 | 1 | 387 | 77,269 |
| 20 March 2008 | Unapproved | 75,575 | 1 | 387 | 291,718 |
| 13 October 2008 | LTIP | 26,550 | 1 | 387 | 102,483 |
| 28 October 2009 | LTIP | 4,892 | 1 | 387 | 18,883 |

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

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## Annual report on remuneration continued

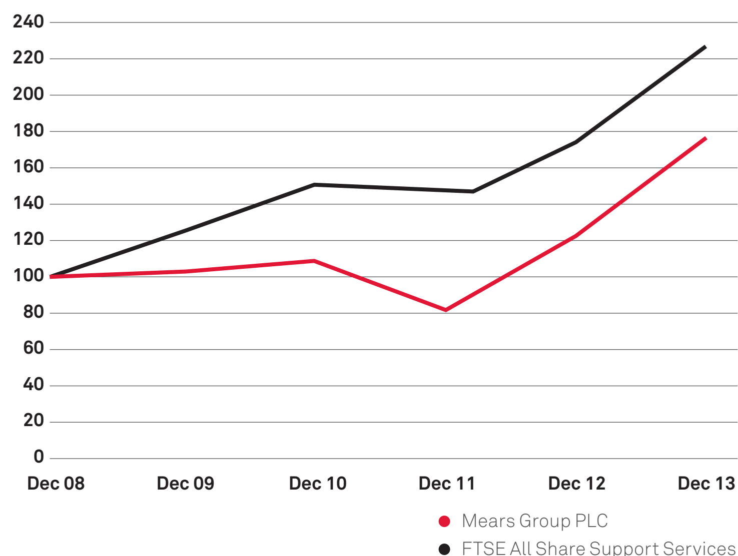
### Shareholder dilution

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

### Performance graph and table

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

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




| Year | Name | Single figure of total remuneration (£'000) | Bonus pay out (as % maximum) opportunity | Long-term incentive vesting rates (as % maximum opportunity) |
|---|---|---|---|---|
| 2013 | D J Miles | 822 | — | 100% |
| 2012 | D J Miles | 409 | 0% | — |
| 2011 | D J Miles | 384 | 0% | — |
| 2010 | D J Miles | 270 | 0% | — |
| | R Holt | 600 | 0% | — |
| 2009 | R Holt | 1,095 | 100% | — |

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

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

| | Salary | | |
|---|---|---|---|
| | Salary | Benefits | Bonus |
| Chief Executive Officer | 0% | +10% | —* |
| Office salaries | 2% | 0% | 0% |

* Given the changes to the remuneration structure during the year the Committee believes that showing the change in the Chief Executive Officer's salary is a more accurate representation of the comparison between Chief Executive Officer and employee pay.

### Relative importance of spend on pay

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

| Significant distributions | Disbursements from profit in financial year £'000 | Disbursements from profit in previous financial year £'000 | % change |
|---|---|---|---|
| Total Directors' pay | 2,375 | 1,456 | 63% |
| Profit distributed by way of dividend | 8,116 | 6,739 | 20% |
| Underlying profit before tax | 36,630 | 29,037 | 26% |

# Remuneration report continued

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

### Executive Directors

Salary

The salaries for the forthcoming year are set out below:

| Executive Director | 2014 | 2013 | % change |
|---|---|---|---|
| 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 | — |

MIP

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

| MIP opportunity | | Performance measure weighting (% award) | |
|---|---|---|---|
| Target (% of salary) | Maximum (% of salary) | Earnings per share | Total Shareholder Return |
| 70% | 250% | 80% | 20% |

The 2014 MIP performance conditions are as follows:

| Condition | Weighting | Payout range (threshold to maximum contribution |
|---|---|---|
| Earnings per Share (EPS) | 80% | 10% – 15% from baseline diluted normalised EPS of 29.6p (pre share-based payments and the costs relating to the MIP). |
| Total Shareholder Return (TSR) | 20% | 10% – 15% from baseline share price of £4.58. |
| EBITA cash conversion (underpin) | 80% | If this measure underpin is not met (but the other is) then the annual contribution, if any, will be reduced by 50%. |
| ROCE (underpin) | 10% | If the underpin is not met (but the other is) then the annual contribution, if any, will be reduced by 50%. |

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

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

» the Company's 2014 business plan;

» consensus forecasts for the Company; and

» alignment with the Company's business strategy.

Pension

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

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

### Non-Executive Directors

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

| | 2014 | 2013 | % change |
|---|---|---|---|
| D L Hosein | **£45,000** | £45,000 | — |
| M G Rogers | **£45,000** | £45,000 | — |
| P F Dicks | **£45,000** | £45,000 | — |
| D Marston | **£45,000** | £45,000 | — |
| R Macnamara | **£45,000** | £45,000 | — |

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

### Role of the Committee and activities

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

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

The Remuneration Committee is responsible for:

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

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

### Annual overview

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

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

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

The membership of the Remuneration Committee and their attendance at Committee meetings are detailed within the Corporate Governance Report. The Committee's activities during the 2013 financial year included:

### Advisers to the Committee

In 2013, the Committee continued to engage PwC and received wholly independent advice on Executive compensation. PwC is a member of the Remuneration Consultants' Group and complies with its code of conduct which sets out guidelines to ensure that its advice is independent and free of undue influence. Fees paid to PwC in respect of these services in the year ended 31 December 2013 were £115,000.

### Statement of voting at general meeting

The table below shows the advisory vote on the Directors' Remuneration Report together with the resolutions in respect of the new MIP and Share Plan:

| Item | Votes for | % | Votes against | % | Votes withheld |
|---|---|---|---|---|---|
| To approve the Directors' Remuneration Report. | 72,082,964 | 95 | 4,143,821 | 5 | 72,812 |
| To approve the establishment of the Mears Group PLC 2013 MIP. | 46,708,984 | 61 | 29,674,218 | 39 | 71,152 |
| To approve the establishment of the Mears Group PLC 2013 Share Plan. | 41,217,189 | 55 | 33,085,634 | 45 | 1,874,474 |

The total number of ordinary shares eligible to vote at the AGM was 98,536,055.

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# Report of the Directors

The Directors present their report together with the consolidated financial statements for the year ended 31 December 2013.

## Principal activities

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

## Business review

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

## Dividend

The final dividend in respect of 2012 of 5.70p per share was paid in July 2013. An interim dividend in respect of 2013 of 2.50p was paid to shareholders in November 2013. The Directors recommend a final dividend of 6.30p per share for payment on 3 July 2014 to shareholders on the Register of Members on 13 June 2014. This has not been included within the consolidated financial statements as no obligation existed at 31 December 2013.

## Corporate governance

A statement on the Group's corporate governance is set out on pages 38 to 42.

## 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 20 and 21.

## Directors

The present membership of the Board is set out with the biographical detail on page 37.

In line with current practice, all of the Directors will retire and, being eligible, offer themselves for re-election at the AGM in June 2014.

The beneficial interests of the Directors in the shares of the Company at 31 December 2013 and 31 December 2012 are detailed within the Remuneration Report on page 60.

The process governing the appointment and replacement of Directors is detailed within the Report of the Nomination Committee on page 43.

## Amendment to Articles of Association

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

## Appointment of Directors

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

## Share capital authorisations

The 2012 AGM held in June 2013 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 £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; 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 £46,008 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 2012 Notice of AGM. Shareholders are also referred to the 2013 Notice of AGM which contains similar provisions in respect of the Company's equity share capital as detailed below.

## AGM

The 2013 AGM will be held at the offices of Buchanan, 107 Cheapside, London EC2V 6DN on 4 June 2014 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 £336,481 plus an additional one third of issued share capital of £336,481 that can only be used for a rights issue or similar fund raising;

» to authorise the Directors to issue shares for cash on a non pre-emptive basis. This authority is limited to 5% of the issued share capital of £50,472 and is required to facilitate technical matters such as dealing with fractional entitlements or possibly a small placing;

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## AGM continued

- to authorise the convening of general meetings (other than an AGM) on 14 days' notice. This results from a European Union Directive that became effective on 3 August 2010 and will override Section 307 of the Companies Act 2006 where the requirement to give 21 days' notice for certain meetings has been amended; and
- to amend the Company's memorandum of association which places a restriction on the authorised share capital of the Company. The requirement for a company to have an authorised share capital was removed when the Companies Act 2006 came into force and the Directors believe that it is no longer appropriate for the Company's share capital to be limited in this way.

## Principal risks and uncertainties

Risk is an accepted part of doing business. The Group's financial risk management is based upon sound economic objectives and good corporate practice. The Board has overall responsibility for risk management and internal control within the context of achieving the Group's objectives. Our process for identifying and managing risks is set out in more detail within the Corporate Governance Statement. The key risks and mitigating factors are set out on pages 22 to 25. Details of financial risk management and exposure to price risk, credit risk and liquidity risk are given in note 21 on pages 104 to 108.

## 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 58 days (2012: 59 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 a general meeting by ordinary resolution but such dividend cannot exceed the amount recommended by the Board.

## Substantial shareholdings

As at 7 March 2014 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 below.

| | Number (m) | % |
|---|---|---|
| Majedie Asset Management | 8.70 | 8.7% |
| Heronbridge Investment Management | 7.92 | 7.9% |
| Legal & General Investment Management | 6.03 | 6.0% |
| Old Mutual Global Investors | 5.28 | 5.3% |
| Denver Investment Advisors | 4.61 | 4.6% |
| Artemis Investment Management | 4.19 | 4.2% |
| Fidelity Worldwide Investment | 3.83 | 3.8% |
| Teachers RS of Georgia | 3.17 | 3.2% |
| Invesco Perpetual | 3.20 | 3.2% |

## Disabled employees

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

## Employee information and consultation

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

## CREST

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

## Auditor

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

On behalf of the Board

**B Westran**
**Company Secretary**
28 March 2014

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# Statement of Directors' responsibilities

In respect of the Directors' Report and financial statements

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

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

» select suitable accounting policies and then apply them consistently;

» make judgements and estimates that are reasonable and prudent;

» state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

» prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

The Directors confirm that:

» so far as each Director is aware there is no relevant audit information of which the Company's auditor is unaware; and

» the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

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

To the best of my knowledge:

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

» the Annual Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

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

## Going concern

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

The Group had net debt of £0.5m at 31 December 2013. The core debt required to satisfy the day-to-day requirements of the business is in the region of £70m. This represents significant headroom against the £120m unsecured revolving credit facility with an additional accordion mechanism allowing the facility to be increased to a maximum of £160m, maturing in July 2018. The original refinancing was completed in 2011 and during 2013 the facility agreement was amended and extended on improved terms.

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

By order of the Board

**A C M Smith**
**Finance Director**
andrew.smith@mearsgroup.co.uk
28 March 2014

# Independent auditor's report

To the members of Mears Group PLC

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We have audited the financial statements of Mears Group PLC for the year ended 31 December 2013 which comprise the Group principal accounting policies, the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement, the Consolidated Statement of Changes in Equity and the related consolidated notes, the Company principal accounting policies, the Parent Company Balance Sheet and the related Company notes.

The financial reporting framework that has been applied in the preparation of the consolidated financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is 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 Statement of Directors' Responsibilities set out on page 66, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

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

## Auditor commentary

### An overview of the scope of our audit

Our audit scope included a full audit of the consolidated and Parent Company financial statements of Mears Group PLC. The Group is currently organised into two principal operating divisions: Social Housing and Care. The consolidated financial statements are a consolidation of 26 subsidiaries comprising the Group's operating businesses within these divisions.

In establishing the overall approach to the Group audit, we determined the work that needed to be performed on the reporting units. The reporting units vary significantly in size and we identified 14 subsidiaries that, in our view, due to their size or risk characteristics required a complete audit of their financial information, providing 99.4% coverage of the Group's underlying profit from operations.

We undertook an interim visit of the Group, focussing on the main divisions, namely Social Housing and Care, in November and December 2013 to evaluate the Group's internal controls environment, including the IT systems. We evaluated and tested controls over key financial systems identified as part of our risk assessment, reviewed the accounts production process, and addressed critical accounting matters. We sought to use evidence from the Group's internal controls wherever possible to form our opinion. We undertook substantive testing on significant transactions, account balances and disclosures, the extent of which was based on various factors such as our overall assessment of the control environment, the effectiveness of controls over individual systems and the management of specific risks.

### Our application of materiality

We apply the concept of materiality in planning and performing our audit, in evaluating the effect of any identified misstatements and in forming our opinion. For the purpose of determining whether the financial statements are free from material misstatement we define materiality as the magnitude of a misstatement or an omission from the financial statements or related disclosures that would make it probable that the judgement of a reasonable person relying on the information would have been changed or influenced by the misstatement or omission. For the consolidated audit, we established materiality for the Group financial statements as a whole to be c.£1.3m, which is 5% of profit for the year before taxation, adjusted for certain items based on auditor judgement. For the financial information of the individual subsidiary undertakings, we set our materiality based on a proportion of Group materiality appropriate to the relative scales of each of the businesses.

### Our assessment of risk

Without modifying our opinion, we highlight the following matters that are, in our judgement, likely to be most important to users' understanding of our audit. Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual transactions, account balances or disclosures.

### Revenue recognition of Social Housing contracts

The revenue from the Group's Social Housing contracts represents 85.8% of the Group's total revenue of £866m. The measurement of revenue to be recognised in the consolidated financial statements in accordance with IAS 18 'Revenue', including the determination of the appropriate timing of recognition, is impacted by the terms and conditions of each contract and can be highly judgemental.

# Independent auditor's report continued

To the members of Mears Group PLC

## Auditor commentary continued

### Revenue recognition of Social Housing contracts continued

We therefore identified revenue recognition relating to these contracts as a significant risk requiring special audit consideration.

Our audit work included, but was not restricted to, an evaluation of the methodology by which the Directors determine the stage of completion for the individual components of each contract. We assessed whether the methodology applied by the Directors is in accordance with the requirements of IAS 18 and consistent with our expectations, based on similar contract activity in this sector. We tested the timing of revenue recognition for a sample of individual contracts, including a review of the stage of completion, contract revenue, contract costs, attributable profits and work-in-progress and assessed potential onerous provisions arising from the contracts. We also evaluated and tested controls over invoicing to assess timing of revenue recognised.

The Group's accounting policy on revenue and disclosure of related critical judgements are included on pages 73 to 75 and page 79 respectively.

### Assessment of goodwill impairment in relation to the Care division

As more fully explained in note 12, the Directors are required to make an annual assessment to determine whether the value of goodwill of £154m is impaired. The process for measuring and recognising impairment under IAS 36 'Impairment of Assets' is complex and highly judgemental, particularly in relation to the Care division which is developing. We therefore identified the impairment review in relation to the Care division as a significant risk requiring special audit consideration.

Our audit work included, but was not restricted to, an evaluation of the methodology and assumptions used by the Directors and their external consultant (management's expert). In particular those key assumptions relating to the divisional forecasted revenue growth rates and profit margins and the appropriateness of the discount rate applied. We compared the methodologies applied and the assumptions used to our expectations and emerging market activity. We also focused on the adequacy of the disclosures on the sensitivity of the key assumptions used in the impairment assessment and the related disclosures.

The Group's accounting policy on impairment is included in the Group's principal accounting policies and details of the judgements and estimates made by the Directors are included in note 12.

### Re-assessment of fair values on the acquisition of Morrison

In November 2012, on the acquisition of Morrison, the Group recognised a provisional fair value for all identifiable assets and liabilities, including contingent liabilities, at the date of the acquisition. In accordance with the requirements of IFRS 3 'Business Combinations', during the course of the twelve month measurement period the Directors have re-assessed these fair values and as a result increased the carrying value of goodwill. The assumptions and estimates applied in measuring the liabilities which form part of the fair values to be recognised in the Consolidated Financial Statements are highly judgemental. We therefore identified the measurement of the liabilities as a significant risk requiring special audit consideration.

Our audit work included, but was not restricted to, an evaluation of the methodology and assumptions by which the Directors determined the valuation of the liabilities. We assessed whether the methodology applied by the Directors was compliant with IFRS 3 'Business Combinations', consistent with our expectations, whether the assumptions used were in line with historical information, the terms of the individual contracts and other relevant market data.

The Group's accounting policy on accounting for business combinations is included in the Group's principal accounting policies and details of the judgements and estimates made by the Directors are included in note 25.

### Management override of financial control

Under ISAs (UK & Ireland), for all of our audits we are required to consider the risk of management override of financial controls. Due to the unpredictable nature of this risk we are required to assess it as a significant risk requiring special audit consideration.

Our audit work included, but was not restricted to, specific procedures relating to this risk that are required by ISA 240 'The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements'. This included tests of journal entries, the evaluation of judgements and assumptions in the Directors' estimates and tests of significant transactions outside the normal course of business.

In particular, our work on revenue recognition of Social Housing contracts and the goodwill impairment assessment for the Care division addressed key aspects of ISA 240.

### 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 2013 and of the Group's profit for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with IFRSs 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 consolidated financial statements, Article 4 of the IAS Regulation.

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## Other reporting responsibilities

**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 Strategic Report and the Directors' Report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements; and

» the information given in the Corporate Governance Statement set out on pages 38 to 42 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 ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

» materially inconsistent with the information in the audited financial statements; or

» apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or

» is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that were communicated to the Audit Committee which we consider should have been disclosed.

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

» adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or

» the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or

» certain disclosures of Directors' remuneration specified by law are not made; or

» we have not received all the information and explanations we require for our audit; 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 66 in relation to going concern; and

» the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review.

**Simon J Lowe**
**(Senior Statutory Auditor)**
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**London**
28 March 2014

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# Principal accounting policies – Group

## Basis of preparation

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

The accounting policies remain unchanged from the previous year except for the adoption of IAS 19 (revised) 'Employee Benefits'; the adoption of amendments to IAS 1 'Presentation of Financial Statements' – presentation of items of Other Comprehensive Income; the adoption of amendments to IAS 32 'Financial Instruments: Presentation' – offsetting financial assets and financial liabilities; and the adoption of IFRS 13 'Fair Value Measurement'.

The adoption of IAS 19 has resulted in the combination of 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 are based on the discount rate instead of the expected rate of return on assets. This change in accounting standards has resulted in the restatement of the prior year results. There has been no change to net assets and, as a result, the Consolidated Balance Sheet for 2011 has not been presented. Further details are given in note 3.

The adoption of amendments to IAS 1 has resulted in the grouping of items included in Other Comprehensive Income on the basis of whether they are potentially reclassifiable to profit of loss.

The adoption of amendments to IAS 32 and the adoption of IFRS 13 have had no material effect of the Group's financial statements.

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

## Basis of consolidation

The Consolidated Balance Sheet includes the assets and liabilities of the Company and its subsidiaries and is made up to 31 December 2013. Entities over which the Group has the ability to exercise control over financial and operating policies are accounted for as subsidiaries. Control is obtained and exercised through voting rights so as to obtain benefits from the subsidiaries' activities. Interests acquired in entities are consolidated from the effective date of acquisition and interests sold are consolidated up to the date of disposal.

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.

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## Property, plant and equipment

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

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

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

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

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

## Intangible assets

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

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

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

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

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

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

# Principal accounting policies – Group continued

## Intangible assets continued

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

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

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

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

## Goodwill

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

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

## Impairment

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

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

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

## Inventories

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

## Work in progress

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

## Amounts recoverable on contracts

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

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## Accounting for taxes

Income tax comprises current and deferred taxation.

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

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

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

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

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

## Revenue

Revenue is measured in accordance with IAS 18 ‘Revenue’ 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.

# Principal accounting policies – Group continued

## Revenue continued

### Social Housing continued

Schedule of Rates (SOR) contracts

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

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

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

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.

## Revenue continued

### 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.

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.

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# Principal accounting policies – Group continued

## 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 32 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 (revised) 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.

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## 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 the share-based payment reserve.

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

## Leases

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

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

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

The Group does not act as a lessor.

## Financial instruments

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

### Financial assets

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

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

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# Principal accounting policies – Group continued

## Financial instruments continued

### Loans and receivables

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

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

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

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

### Financial liabilities

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

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

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

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

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

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

## Derivative financial instruments

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

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

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## 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 73 to 74, 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.

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# Principal accounting policies – Group continued

## Use of judgements and estimates continued

### 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 12.

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.

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

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 IFRS 7 'Financial Instruments: Disclosures' – offsetting financial assets and financial liabilities (effective 1 January 2014). The revised standard requires 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 this revised standard for the Group's 31 December 2014 financial statements.

IFRS 9 'Financial Instruments' (not yet endorsed by the EU) specifies how an entity should classify and measure financial assets, including some hybrid contracts. The Group is expected to apply this standard for the Group's 31 December 2018 financial statements, subject to endorsement by the EU.

IFRS 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.

Amendments to IAS 39 'Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting'.

# Consolidated income statement

For the year ended 31 December 2013

| | Note | 2013 £'000 | 2012 (restated) £'000 |
|---|---|---|---|
| **Continuing operations** | | | |
| **Sales revenue** | 1 | **865,574** | 617,236 |
| Cost of sales | | **(641,115)** | (438,833) |
| **Gross profit** | | **224,459** | 178,403 |
| Other administrative expenses | | **(183,344)** | (145,644) |
| Exceptional costs | 7 | **(6,663)** | (2,877) |
| Amortisation of acquisition intangibles | 13 | **(10,860)** | (7,961) |
| **Total administrative costs** | | **(200,867)** | (156,482) |
| Operating profit before exceptional costs and amortisation of acquisition intangibles | | **41,115** | 32,759 |
| **Operating profit** | | **23,592** | 21,921 |
| Finance income | 4 | **2,119** | 954 |
| Finance costs | 4 | **(3,966)** | (2,921) |
| Profit for the year before tax, exceptional costs and the amortisation of acquisition intangibles | | **39,268** | 30,792 |
| **Profit for the year before tax** | | **21,745** | 19,954 |
| Tax expense | 8 | **(4,757)** | (1,768) |
| **Profit for the year from continuing operations** | | **16,988** | 18,186 |
| **Discontinued operations** | | | |
| Loss for the year before exceptional costs and before tax from discontinued operations | 9 | **(2,638)** | (1,755) |
| Exceptional costs from discontinued operations | 9 | **(18,830)** | — |
| Tax expense from discontinued operations | 9 | **3,307** | 854 |
| **Loss for the year after tax from discontinued operations** | | **(18,161)** | (901) |
| **(Loss)/profit for the year from continuing and discontinued operations** | | **(1,173)** | 17,285 |
| | | | |
| **Attributable to:** | | | |
| Owners of the parent | | **(942)** | 17,624 |
| Non-controlling interest | | **(231)** | (339) |
| **(Loss)/profit for the year** | | **(1,173)** | 17,285 |
| | | | |
| **Earnings per share** | | | |
| Basic | 11 | **(1.21p)** | 19.61p |
| Diluted | 11 | **(1.17p)** | 18.85p |

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

# Consolidated statement of comprehensive income

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| | Note | 2013 £'000 | 2012 (restated) £'000 |
|---|---|---|---|
| **Net (loss)/profit for the year** | | **(1,173)** | 17,285 |
| Other comprehensive income/(expense): | | | |
| Which will be subsequently reclassified to the Income Statement | | | |
| Cash flow hedges: | | | |
| – gains/(losses) arising in the year | 21 | **593** | (1,311) |
| – reclassification to Income Statement | 21 | **791** | 505 |
| (Decrease)/increase in deferred tax asset in respect of cash flow hedges | 21 | **(319)** | 152 |
| Which will not be subsequently reclassified to the Income Statement | | | |
| Actuarial (loss)/gain on defined benefit pension scheme | 26 | **(2,196)** | 329 |
| Increase/(decrease) in deferred tax asset in respect of defined benefit pension schemes | 22 | **577** | (220) |
| Other comprehensive expense for the year | | **(554)** | (545) |
| Total comprehensive (expense)/income for the year | | **(1,727)** | 16,740 |
| **Attributable to:** | | | |
| Owners of the parent | | **(1,496)** | 17,079 |
| Non-controlling interest | | **(231)** | (339) |
| Total comprehensive (expense)/income for the year | | **(1,727)** | 16,740 |

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

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# Consolidated balance sheet

As at 31 December 2013

| | Note | 2013 £'000 | 2012 (restated) £'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current** | | | |
| Goodwill | 12 | **157,945** | 138,369 |
| Intangible assets | 13 | **35,646** | 39,365 |
| Property, plant and equipment | 14 | **15,068** | 15,981 |
| Pension and other employee benefits | 26 | **14,731** | 14,023 |
| Deferred tax asset | 22 | **10,570** | 15,428 |
| Trade and other receivables | 17 | **—** | 2,798 |
| | | **233,960** | 225,964 |
| **Current** | | | |
| Inventories | 16 | **10,452** | 11,833 |
| Trade and other receivables | 17 | **151,693** | 180,270 |
| Cash at bank and in hand | | **79,552** | 57,616 |
| | | **241,697** | 249,719 |
| **Total assets** | | **475,657** | 475,683 |
| **Equity** | | | |
| **Equity attributable to the shareholders of Mears Group PLC** | | | |
| Called up share capital | 23 | **1,007** | 919 |
| Share premium account | | **56,082** | 34,910 |
| Share-based payment reserve | | **1,050** | 1,685 |
| Hedging reserve | | **(848)** | (1,913) |
| Merger reserve | | **46,214** | 46,214 |
| Retained earnings | | **77,366** | 87,342 |
| **Total equity shareholders' funds** | | **180,871** | 169,157 |
| Non-controlling interest | | **(570)** | (339) |
| **Total equity** | | **180,301** | 168,818 |
| **Liabilities** | | | |
| **Non-current** | | | |
| Long-term borrowing and overdrafts | 21 | **55,000** | 55,000 |
| Pension and other employee benefits | 26 | **6,107** | 5,741 |
| Deferred tax liabilities | 22 | **9,764** | 11,488 |
| Financing liabilities | 19 | **701** | 1,823 |
| Other liabilities | 20 | **1,278** | 879 |
| | | **72,850** | 74,931 |
| **Current** | | | |
| Short-term borrowings and overdrafts | 21 | **25,000** | 15,000 |
| Trade and other payables | 18 | **196,975** | 213,508 |
| Financing liabilities | 19 | **478** | 711 |
| Current tax liabilities | | **53** | 2,715 |
| **Current liabilities** | | **222,506** | 231,934 |
| **Total liabilities** | | **295,356** | 306,865 |
| **Total equity and liabilities** | | **475,657** | 475,683 |

The financial statements were approved and authorised for issue by the Board of Directors and were signed on its behalf on 28 March 2014.

**R Holt**
**Director**

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

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

# Consolidated cash flow statement

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| | Note | 2013 £'000 | 2012 £'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Result for the year before tax | | **21,745** | 19,954 |
| Adjustments | 24 | **18,558** | 13,757 |
| Change in inventories | | **1,291** | 1,988 |
| Change in trade and other receivables | | **9,242** | (16,128) |
| Change in trade and other payables | | **(11,920)** | 19,287 |
| Cash inflow from operating activities of continuing operations before taxation | | **38,916** | 38,858 |
| Taxes paid | | **(3,099)** | (3,339) |
| Net cash inflow from operating activities of continuing operations | | **35,817** | 35,519 |
| Net cash outflow from operating activities of discontinued operations | | **(3,632)** | (2,636) |
| Net cash inflow from operating activities | | **32,185** | 32,883 |
| **Investing activities** | | | |
| Additions to property, plant and equipment | | **(3,660)** | (3,321) |
| Additions to other intangible assets | | **(1,169)** | (1,115) |
| Proceeds from disposals of property, plant and equipment | | **6** | 27 |
| Acquisition of subsidiary undertakings, net of cash | | **(23,617)** | (19,692) |
| Interest received | | **2** | 11 |
| Net cash outflow from investing activities of continuing operations | | **(28,438)** | (24,090) |
| Net cash outflow from investing activities of discontinued operations | | **(1,390)** | (72) |
| Net cash outflow from investing activities | | **(29,828)** | (24,162) |
| **Financing activities** | | | |
| Proceeds from share issue | | **21,260** | 1,389 |
| Discharge of finance lease liability | | **—** | (38) |
| Interest paid | | **(3,565)** | (2,133) |
| Dividends paid | | **(8,116)** | (6,739) |
| Net cash inflow/(outflow) from financing activities of continuing operations | | **9,579** | (7,521) |
| Net cash outflow from financing activities of discontinued operations | | **—** | (155) |
| Net cash inflow/(outflow) from financing activities | | **9,579** | (7,676) |
| Cash and cash equivalents, beginning of year | | **(12,384)** | (13,429) |
| Net increase in cash and cash equivalents | | **11,936** | 1,045 |
| **Cash and cash equivalents, end of year** | | **(448)** | (12,384) |

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Cash and cash equivalents comprises the following: | | |
| – cash at bank and in hand | **79,552** | 57,616 |
| – borrowings and overdrafts | **(80,000)** | (70,000) |
| **Cash and cash equivalents** | **(448)** | (12,384) |

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

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# Consolidated statement of changes in equity

For the year ended 31 December 2013

| | 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 (restated) £'000 | Non-controlling interest £'000 | Total equity £'000 |
| At 1 January 2012 | 857 | 33,554 | 2,965 | (1,259) | 38,243 | 77,425 | — | 151,785 |
| Net result for the year | — | — | — | — | — | 17,624 | (339) | 17,285 |
| Other comprehensive income | — | — | — | (654) | — | 109 | — | (545) |
| Total comprehensive (expense)/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 1 January 2013 | 919 | 34,910 | 1,685 | (1,913) | 46,214 | 87,342 | (339) | 168,818 |
| Net result for the year | — | — | — | — | — | (942) | (231) | (1,173) |
| Other comprehensive income/(expense) | — | — | — | 1,065 | — | (1,619) | — | (554) |
| **Total comprehensive income/(expense) for the year** | — | — | — | 1,065 | — | (2,561) | (231) | (1,727) |
| Deferred tax on share-based payments | — | — | — | — | — | (599) | — | (599) |
| Issue of shares | 88 | 21,172 | — | — | — | — | — | 21,260 |
| Share option charges | — | — | 665 | — | — | — | — | 665 |
| Exercise of share options | — | — | (1,300) | — | — | 1,300 | — | — |
| Dividends | — | — | — | — | — | (8,116) | — | (8,116) |
| **At 31 December 2013** | **1,007** | **56,082** | **1,050** | **(848)** | **46,214** | **77,366** | **(570)** | **180,301** |

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

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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 comprised the provision of design and build M&E services. This activity was discontinued during the year.

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 costs relating to the long-term incentive plans.

| | **2013** | | | 2012 | | |
|---|---|---|---|---|---|---|
| Operating segments | **Social Housing £'000** | **Care £'000** | **Total £'000** | Social Housing (restated) £'000 | Care (restated) £'000 | Total (restated) £'000 |
| **Revenue** | **742,479** | **123,095** | **865,574** | 504,686 | 112,550 | 617,236 |
| **Operating result pre amortisation of acquisition intangibles, exceptional costs and long-term incentive plans** | **33,530** | **9,623** | **43,153** | 23,682 | 9,302 | 32,984 |
| Operating margin pre amortisation of acquisition intangibles, exceptional costs and long-term incentive plans | **4.52%** | **7.82%** | **4.99%** | 4.7% | 8.3% | 5.4% |
| Long-term incentive plans | **(2,038)** | **—** | **(2,038)** | (210) | (15) | (225) |
| **Operating result pre amortisation of acquisition intangibles and exceptional costs** | **31,492** | **9,623** | **41,115** | 23,472 | 9,287 | 32,759 |
| Exceptional costs | | | **(6,663)** | | | (2,877) |
| Amortisation of acquisition intangibles | | | **(10,860)** | | | (7,961) |
| Finance costs, net | | | **(1,847)** | | | (1,967) |
| Tax expense | | | **(4,757)** | | | (1,768) |
| **Profit for the year from continuing activities** | | | **16,988** | | | 18,186 |

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 5% of the total revenue reported.

# Notes to the financial statements – Group continued

For the year ended 31 December 2013

## 1. Segment reporting continued

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

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| Operating segments | Social Housing £'000 | Care £'000 | Other £'000 | Total £'000 | Social Housing (restated) £'000 | Care £'000 | Other £'000 | Total (restated) £'000 |
| Segment assets | **349,860** | **125,797** | **—** | **475,657** | 341,066 | 103,734 | 30,883 | 475,683 |
| Segment liabilities | **(238,975)** | **(56,381)** | **—** | **(295,356)** | (248,681) | (35,340) | (22,844) | (306,865) |
| Property, plant and equipment additions | **3,762** | **431** | **22** | **4,215** | 3,577 | 215 | 73 | 3,865 |
| Depreciation | **4,126** | **620** | **178** | **4,924** | 2,772 | 673 | 249 | 3,694 |
| Amortisation of acquisition intangibles | **5,955** | **4,905** | **—** | **10,860** | 4,967 | 2,994 | — | 7,961 |
| Finance income | **2,051** | **68** | **85** | **2,204** | 948 | 6 | — | 954 |
| Finance costs | **(2,596)** | **(1,370)** | **—** | **(3,966)** | (1,742) | (1,177) | (157) | (3,076) |
| Profit/(loss) before tax | **18,329** | **3,416** | **(21,468)** | **277** | 14,833 | 5,121 | (1,755) | 18,199 |

## 2. Operating costs

Operating costs, relating to continuing activities, include:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Share-based payments | **665** | 250 |
| Long-term incentives | **1,373** | — |
| Depreciation | **4,748** | 3,444 |
| Amortisation | **11,904** | 8,856 |
| Loss on disposal of property, plant and equipment | **(215)** | (16) |
| Hire of plant and machinery | **4,944** | 3,845 |
| Other operating lease rentals | **24,644** | 18,918 |

Fees payable for audit and non-audit services during the year are as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Fees payable to the auditor for the audit of the Group's financial statements | **56** | 64 |
| Other fees payable to the auditor in respect of: | | |
| – auditing of accounts of subsidiary undertakings pursuant to legislation | **214** | 241 |
| – auditing of Group pension schemes | **—** | 17 |
| – taxation compliance fees | **33** | 43 |
| – taxation advice fees | **17** | — |
| – internal audit effectiveness review | **25** | — |
| Total auditor's remuneration | **345** | 365 |

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## 3. Prior period adjustment

IAS 19 (revised) 'Employee Benefits' is applicable for accounting periods beginning on or after 1 January 2013 and so has been applied for the first time. 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 are based on the discount rate instead of the expected rate of return on assets. This change in accounting standards has resulted in the restatement of the prior year results.

The change has resulted in a lower expected return in the Consolidated Income Statement and a higher gain in the Consolidated Statement of Comprehensive Income. The effect on the Consolidated Income Statement for 2012 is an increase in operating costs of £0.3m and a decrease in finance income of £2.3m. There is a corresponding decrease in the actuarial loss recognised in the Statement of Consolidated Income of £2.6m. There is no change to net assets and consequently no Consolidated Balance Sheet for 2011 has been presented.

## 4. Finance income and finance costs

| | 2013 £'000 | 2012 (restated) £'000 |
|---|---|---|
| Interest charge on overdrafts and short-term loans | **(2,401)** | (2,054) |
| Interest charge on interest rate swap | **(791)** | (505) |
| Other interest | **—** | (19) |
| Finance costs on bank loans, overdrafts and finance leases | **(3,192)** | (2,578) |
| Interest charge on defined benefit obligation | **(401)** | (303) |
| Unwinding of discounting | **(373)** | (40) |
| **Total finance costs** | **(3,966)** | (2,921) |
| Interest income resulting from short-term bank deposits | **2** | 11 |
| Interest income resulting from defined benefit obligation | **2,117** | 943 |
| **Finance income** | **2,119** | 954 |
| Net finance charge on continuing operations | **(1,847)** | (1,967) |
| Net finance income/(charge) on discontinued operations | **85** | (155) |
| Net finance charge | **(1,762)** | (2,122) |
| **Interest recognised in other comprehensive income** | | |
| Gains/(losses) arising in the year | **593** | (1,311) |
| Reclassification to the Income Statement | **791** | 505 |
| Changes in mark-to-market of interest rate swaps (effective hedges) | **1,384** | (806) |

## 5. Employees

Staff costs during the year were as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Wages and salaries | **274,617** | 213,895 |
| Social security costs | **23,968** | 17,857 |
| Other pension costs | **10,450** | 4,388 |
| Total continuing operations | **309,035** | 236,140 |
| Discontinued operations | **5,181** | 7,079 |
| Total continuing and discontinued operations | **314,216** | 243,219 |

# Notes to the financial statements – Group continued

For the year ended 31 December 2013

## 5. Employees continued

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

| | 2013 Number | 2012 Number |
|---|---|---|
| Site workers | **4,358** | 3,157 |
| Carers | **8,060** | 5,734 |
| Office and management | **2,974** | 2,393 |
| Total continuing operations | **15,392** | 11,284 |
| Discontinued operations | **140** | 157 |
| Total continuing and discontinued operations | **15,532** | 11,441 |

Remuneration in respect of Directors was as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Emoluments | **2,190** | 1,273 |
| Gains made on the exercise of share options | **5,139** | 4,392 |
| Pension contributions to personal pension schemes | **185** | 185 |
| | **7,514** | 5,850 |

During the year contributions were paid to personal pension schemes for four Directors (2012: four).

During the year three Directors (2012: two) exercised share options.

## 6. Share-based employee remuneration

As at 31 December 2013 the Group maintained five share-based payment schemes for employee remuneration.

Details of the share options outstanding are as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Number '000 | Weighted average exercise price p | Number '000 | Weighted average exercise price p |
| Outstanding at 1 January | **5,186** | **63** | 8,342 | 60 |
| Granted | **524** | **1** | 1,353 | 1 |
| Forfeited/lapsed | **(856)** | **28** | (1,141) | 33 |
| Exercised | **(2,434)** | **86** | (3,368) | 40 |
| Outstanding at 31 December | **2,420** | **40** | 5,186 | 63 |

The weighted average share price at the date of exercise for share options exercised during the period was £4.11. The options outstanding at 31 December 2013 were exercisable at prices between 1p and 300p and had a weighted average remaining contractual life of three 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.

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## 6. Share-based employee remuneration continued

The underlying expected share price volatility was determined by reference to historical data. The Company expects the volatility of its share price to reduce as it matures. The risk-free interest rate was determined by the implied yield available on a zero-coupon Government bond at the date of grant. Adjustments are made to reflect expected and actual forfeitures during the vesting period due to failure to satisfy service conditions. In the case of the SAYE scheme the expected forfeitures take account of the requirement to save throughout the life of the scheme. There were 0.5m options granted during the year and 0.9m options lapsed during the year. The market price at 31 December 2013 was 475p and the range during 2013 was 313p to 481p.

At 31 December 2013, 1.8m options had vested and were still exercisable at a weighted average exercise price of 51p.

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:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| LTIP | **202** | 157 |
| Unapproved share option plan | **—** | (12) |
| SAYE | **79** | 105 |
| Share Plan | **384** | — |
| | **665** | 250 |

In total, £0.7m of employee remuneration expense has been included in the Consolidated Income Statement for 2013 (2012: £0.25m), which gave rise to additional share-based payment reserves. No liabilities were recognised due to share-based payment transactions.

### The Mears Group PLC Long-term Incentive Plan

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.<br>75% of the LTIP Award will relate to an EPS growth target. The other 25% of the LTIP Award relates to the Company's TSR against the return of the FTSE All Share Support Services Sector. |
| Expiry conditions | Options are forfeited if the employee leaves the Group before the options have vested. |

Performance conditions of LTIP (2010 issue)

| EPS growth target | | TSR target | |
|---|---|---|---|
| Performance levels | Level of vesting | Performance levels | Level of vesting |
| 8.0% | 10% | Below index return | 0% |
| 10.0% | 30% | Equal to index | 30% |
| 12.5% | 100% | 10% out performance of the index p.a. | 100% |

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## 6. Share-based employee remuneration continued

### Approved share option plan

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

### Unapproved share option plan

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

### Save As You Earn (SAYE) scheme

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

### Special Incentive Plan 2007 (SIP)

The SIP was introduced in 2007 to reward the then Chief Executive Officer, Bob Holt, with premium priced options linked to long-term performance. The terms and conditions were subsequently amended on 3 July 2009. If the options remain unexercised after a period of ten years from the date of grant, the options expire. There was a single award and no further awards will be made under this plan.

### The Mears Group PLC Share Plan (2013)

The share plan was introduced in June 2013 following shareholder approval. The award of options is offered to a small number of key Senior Management. The principal terms of the LTIP are detailed below:

| Principal terms of LTIP | |
|---|---|
| Number of options | Maximum award limit under the plan will be 200% of salary p.a. |
| Exercise price | 1p |
| Vesting period | 3 year (future awards under this plan will be subject to a 5 year vesting period). |
| Performance conditions | None |
| Expiry conditions | Options are forfeited if the employee leaves the Group before the options have been vested. |

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## 7. Exceptional costs

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

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Costs of acquisitions | **200** | 830 |
| Costs of integration | **6,463** | 2,047 |
| Total continuing operations | **6,663** | 2,877 |
| Total discontinued operations (see note 9) | **18,830** | — |
| Total continuing and discontinued operations | **25,493** | 2,877 |

The costs of acquisition in the current period relate to the acquisition of ILS Group Limited. The costs of acquisition in the previous period relate to the acquisition of Morrison Facilities Services Limited.

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

Exceptional costs on discontinued activities relate to the loss on disposal and associated costs of disposals of Haydon Mechanical & Electrical Limited.

## 8. Tax expense

**Tax recognised in the Income Statement:**

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| United Kingdom corporation tax effective rate 30.1% (2012: 20.0%) | **3,360** | 5,242 |
| Adjustment in respect of previous periods | **(23)** | (698) |
| Total current tax recognised in Income Statement | **3,337** | 4,544 |
| Deferred taxation charge: | | |
| – on defined benefit pension obligations | **533** | 325 |
| – on share-based payments | **524** | 18 |
| – on accelerated capital allowances | **(200)** | (220) |
| – on amortisation of acquisition intangibles | **(2,364)** | (1,100) |
| – on short-term temporary timing differences | **178** | 328 |
| – on corporate tax losses | **2,655** | (1,773) |
| – impact of change in statutory tax rates | **94** | (354) |
| Total deferred taxation recognised in Income Statement | **1,420** | (2,776) |
| Total tax expense recognised in Income Statement on continuing operations | **4,757** | 1,768 |
| Total tax credit recognised in Income Statement on discontinued operations | **(3,307)** | (854) |
| Total tax expense recognised in Income Statement | **1,450** | 914 |

# Notes to the financial statements – Group continued

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## 8. Tax expense continued

**Tax recognised in the Income Statement** continued

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

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Results for the year before tax | **21,745** | 19,954 |
| Result for the year multiplied by standard rate of corporation tax in the United Kingdom for the period of 23.25% (2012: 24.5%) | **5,056** | 4,889 |
| Effect of: | | |
| – expenses not deductible for tax purposes | **687** | 1,080 |
| – capital allowances in excess of depreciation | **71** | (104) |
| – tax relief on exercise of share options | **(1,127)** | (1,682) |
| – statutory tax rate changes | **93** | (426) |
| – tax rate difference | **—** | (5) |
| – tax losses included within loss from discontinued operations | **(3,307)** | (854) |
| – temporary differences including tax losses not recognised in deferred tax | **—** | (1,286) |
| – adjustment in respect of prior periods | **(23)** | (698) |
| Actual tax expense | **1,450** | 914 |

The following tax has been charged to other comprehensive income or equity during the year:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| **Deferred tax recognised in other comprehensive income** | | |
| – on defined benefit pension obligations | **(461)** | 77 |
| – on cash flow hedges | **269** | (185) |
| – impact of change in statutory tax rates | **(66)** | 176 |
| Total deferred taxation recognised in other comprehensive income | **(258)** | 68 |
| **Deferred tax recognised directly in equity** | | |
| Deferred taxation charge: | | |
| – on share-based payments | **425** | 2,239 |
| – impact of change in statutory tax rates | **174** | 368 |
| Total deferred taxation recognised in equity | **599** | 2,607 |
| **Total tax** | | |
| Total current tax | **30** | 3,690 |
| Total deferred tax | **1,761** | (101) |

## 9. Discontinued operations

On 5 November 2013 the Group entered into a sale agreement to dispose of Haydon Mechanical & Electrical Limited, which undertook design and build M&E services. The disposal was completed on 21 November 2013. The results of the operations which have been included in the Consolidated Financial Statements are as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Sales revenue | **32,632** | 62,289 |
| Cost of sales | **(29,131)** | (56,387) |
| Administrative expenses | **(6,224)** | (7,500) |
| Finance income, net | **85** | (157) |
| Loss for the year before tax on discontinued operations | **(2,638)** | (1,755) |
| Loss on disposal and other associated costs | **(18,830)** | — |
| Tax on discontinued operations | **3,307** | 854 |
| Tax on loss on disposal | **—** | — |
| Loss for the year after tax on discontinued operations | **(18,161)** | (901) |

Operating costs include:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Depreciation | **176** | 250 |
| Amortisation | **202** | 57 |
| Loss on disposal of property, plant and equipment | **—** | — |
| Hire of plant and machinery | **117** | 230 |
| Other operating lease rentals | **644** | 736 |

Further details of the disposal are given in note 25.

The loss on disposal in respect of discontinued activities is all attributable to the equity holders of the parent.

## 10. Dividends

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

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Final 2012 dividend of 5.70p (2012: final 2011 dividend of 5.35p) per share | **5,617** | 4,698 |
| Interim 2013 dividend of 2.50p (2012: interim 2012 dividend of 2.30p) per share | **2,499** | 2,041 |
| | **8,116** | 6,739 |

The proposed final 2013 dividend of 6.30p per share has not been included within the Consolidated Financial Statements as no obligation existed at 31 December 2013.

# Notes to the financial statements – Group continued

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## 11. Earnings per share

| | Basic (continuing) | | Basic (discontinued) | | Basic (continuing and discontinued) | |
|---|---|---|---|---|---|---|
| | **2013 p** | 2012 (restated) p | **2013 p** | 2012 (restated) p | **2013 p** | 2012 (restated) p |
| Earnings per share | **17.50** | 20.63 | **(18.71)** | (1.02) | **(1.21)** | 19.61 |
| Effect of amortisation of acquisition intangibles | **11.19** | 9.03 | **—** | — | **11.19** | 9.03 |
| Effect of full tax adjustment | **(2.91)** | (5.75) | **1.74** | (0.48) | **(1.17)** | (6.23) |
| Effect of exceptional costs (including tax impact) | **5.26** | 2.47 | **14.89** | — | **20.15** | 2.47 |
| Normalised earnings per share | **31.04** | 26.38 | **(2.08)** | (1.50) | **28.96** | 24.88 |
| Effect of Morrison acquisition | **—** | 1.76 | **—** | — | **—** | 1.76 |
| Normalised earnings per share before losses generated by the Morrison acquisition | **31.04** | 28.14 | **(2.08)** | (1.50) | **28.96** | 26.64 |

| | Diluted (continuing) | | Diluted (discontinued) | | Diluted (continuing and discontinued) | |
|---|---|---|---|---|---|---|
| | **2013 p** | 2012 (restated) p | **2013 p** | 2012 (restated) p | **2013 p** | 2012 (restated) p |
| Earnings per share | **16.96** | 19.83 | **(18.13)** | (0.98) | **(1.17)** | 18.85 |
| Effect of amortisation of acquisition intangibles | **10.84** | 8.68 | **—** | — | **10.84** | 8.68 |
| Effect of full tax adjustment | **(2.82)** | (5.53) | **1.68** | (0.46) | **(1.14)** | (5.99) |
| Effect of exceptional costs (including tax impact) | **5.10** | 2.37 | **14.43** | — | **19.53** | 2.37 |
| Normalised earnings per share | **30.08** | 25.35 | **(2.02)** | (1.44) | **28.06** | 23.91 |
| Effect of Morrison acquisition | **—** | 1.69 | **—** | — | **—** | 1.69 |
| Normalised earnings per share before losses generated by the Morrison acquisition | **30.08** | 27.04 | **(2.02)** | (1.44) | **28.06** | 25.60 |

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

| | Normalised (continuing) | | Normalised (discontinued) | | Normalised (continuing and discontinued) | |
|---|---|---|---|---|---|---|
| | **2013 £'000** | 2012 (restated) £'000 | **2013 £'000** | 2012 (restated) £'000 | **2013 £'000** | 2012 (restated) £'000 |
| Profit/(loss) attributable to shareholders: | **16,988** | 18,186 | **(18,161)** | (901) | **(1,173)** | 17,285 |
| – amortisation of acquisition intangibles | **10,860** | 7,961 | **—** | — | **10,860** | 7,961 |
| – full tax adjustment | **(2,824)** | (5,071) | **1,685** | (424) | **(1,139)** | (5,495) |
| – exceptional costs (including tax impact) | **5,114** | 2,172 | **14,452** | — | **19,566** | 2,172 |
| Normalised earnings | **30,138** | 23,248 | **(2,024)** | (1,325) | **28,114** | 21,923 |
| – Morrison acquisition (including tax impact) | **—** | 1,436 | **—** | — | **—** | 1,436 |
| Normalised earnings before losses generated by the Morrison acquisition | **30,138** | 24,684 | **(2,024)** | (1,325) | **28,114** | 23,359 |

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.

| | **2013 Millions** | 2012 Millions |
|---|---|---|
| Weighted average number of shares in issue: | **97.09** | 88.14 |
| – dilutive effect of share options | **3.10** | 3.57 |
| Weighted average number of shares for calculating diluted earnings per share | **100.19** | 91.71 |

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## 11. Earnings per share continued

The weighted average number of shares in issue for 2012, 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 for 2012, excluding those issued in respect of the acquisition of Morrison, was 91.29m.

## 12. Goodwill

| | Goodwill arising on consolidation (restated) £'000 | Purchased goodwill £'000 | Total (restated) £'000 |
|---|---|---|---|
| **Gross carrying amount** | | | |
| At 1 January 2012 | 100,624 | 406 | 101,030 |
| Additions (restated) | 37,298 | — | 37,298 |
| Revision | 41 | — | 41 |
| At 1 January 2013 | 137,963 | 406 | 138,369 |
| Additions | 19,576 | — | 19,576 |
| **At 31 December 2013** | **157,539** | **406** | **157,945** |
| **Accumulated impairment losses** | | | |
| At 1 January 2012, at 1 January 2013 and at 31 December 2013 | — | — | — |
| **Carrying amount** | | | |
| **At 31 December 2013** | **157,539** | **406** | **157,945** |
| At 31 December 2012 | 137,963 | 406 | 138,369 |

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.

The revision to the goodwill additions in the prior year totalling £14.1m relates to reductions to the estimated fair value of net assets acquired. The reduction in fair value of net assets acquired relates to costs not accrued at the time of the acquisition and an increase to an onerous contract accrual. The revisions are 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 allocated to the following CGUs:

| | Goodwill arising on consolidation £'000 | Purchased goodwill £'000 | Total £'000 |
|---|---|---|---|
| Social Housing | 60,675 | 406 | 61,081 |
| Care | 96,864 | — | 96,864 |
| | **157,539** | **406** | **157,945** |

An asset is impaired if its carrying value exceeds the unit's recoverable amount which is based upon value in use. At 31 December 2013 impairment reviews were performed by comparing the carrying value of the CGU with the value in use of the CGUs to which goodwill has been allocated. The value in use is calculated based upon the cash flow projections of the latest one-year budget forecast extrapolated for a further four years by a growth rate applicable to each unit and an appropriate terminal value based on a perpetuity.



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## 12. Goodwill continued

The rates used were as follows:

| | Post tax discount rate | Pre tax discount rate | Growth rates (year 1–2) | Growth rates (years 3–4) | Growth rates (years 5) | Terminal growth rate |
|---|---|---|---|---|---|---|
| Social Housing | 9.8% | 11.6% | 5% | 5% | 5% | 2.5% |
| Care | 9.6% | 11.4% | 2% | 10% | 7% | 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 terminal growth assumption of 2.5%, which whilst marginally higher than the UK long-term growth rate of 2.25% is supported by historic organic growth.

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

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

### Care

The care-at-home market will continue to present strong growth opportunities, particularly from 2015 onwards. The Directors believe that future growth is underpinned by a number of factors including:

- the number of people aged over 65, who make up the bulk of Care expenditure, is forecast to grow, with the number of people over the age of 65 forecast to make up 24% of the population in 2036 compared to 17.5% in 2012. This is a rise of about 6.3m people;
- the NHS is tasked with investing more in Continuing Health Care (CHC) spend in the community and with joining up its services with Social Care. The community health service market was worth £1.1 billion in 2010 and is expected to rise to £2.0 billion by 2015. This represents a compound average growth rate of 12.7%. There are an increasing number of areas with joint commissioning between the NHS and Social Care, with the newly established Health and Well Being Boards being encouraged to continue this process of integration against clearly agreed local priorities. A £3.8 billion 'Better care fund' is being set aside from within NHS budgets, to specifically support integrated health and social care work, such as around hospital discharge work and palliative care;
- residential care remains a more expensive solution and one that is generally less preferred by service users. Given the considerable financial challenges facing the UK economy, care at home will benefit from this situation;
- continued policy directives, referencing the Dilnot Report, are supporting increased spend on Care services, the most recent announcement being a £72,000 cap on the amount an individual will have to spend on funding their own care in the future. This will enable the development of more cost effective insurance products for those people wanting to protect themselves against paying for their own care in the future;
- there is rising political concern about the current under funding of the sector, which management believes will lead to further funding announcements in the future; and
- a little over 10% of the market continues to be delivered by Local Authority in-house services; however, in parts of the United Kingdom, notably Scotland, this is as high as 50%. Mears has been growing its presence within the areas which currently have high levels of in-sourcing. Given the lower costs within the private sector, further outsourcing is very likely.

The impairment reviews have incorporated growth rates as detailed in the table above.

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## 12. Goodwill continued

**Care** continued

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

The Directors consider that the Care value in use is most sensitive to changes in the terminal growth rate. The sensitivity of the calculated value in use to changes in explicit growth rate, terminal growth rate and discount rate is shown in the table below. The red 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.

| | Discount rate | | | | | | |
|---|---|---|---|---|---|---|---|
| Long-term growth rate | 8.1% | 8.3% | 9.1% | 9.6% | 10.1% | 10.6% | 11.1% |
| 1.5% | 30,446 | 20,179 | 11,269 | 3,465 | **(3,425)** | **(9,553)** | **(15,037)** |
| 1.8% | 34,693 | 23,757 | 14,315 | 6,083 | **(1,158)** | **(7,576)** | **(13,303)** |
| 2.0% | 39,289 | 27,606 | 17,576 | 8,872 | 1,248 | **(5,485)** | **(11,473)** |
| 2.3% | 44,277 | 31,759 | 21,075 | 11,851 | 3,807 | **(3,268)** | **(9,539)** |
| 2.5% | 49,710 | 36,251 | 24,839 | **15,040** | 6,535 | **(914)** | **(7,493)** |
| 2.8% | 55,651 | 41,128 | 28,899 | 18,461 | 9,449 | 1,589 | **(5,325)** |
| 3.0% | 62,174 | 46,440 | 33,292 | 22,142 | 12,567 | 4,257 | **(3,023)** |
| 3.3% | 69,370 | 52,249 | 38,060 | 26,112 | 15,913 | 7,107 | **(574)** |
| 3.5% | 77,348 | 58,626 | 43,254 | 30,408 | 19,513 | 10,157 | 2,036 |

It is only when a simultaneous unfavourable change of greater than 1.5% occurs in the discount rate that the headroom falls below zero.

The table below shows sensitivity (£'000) to simultaneous changes in the discount rate and EBITA margin.

| | Discount rate | | | | | | |
|---|---|---|---|---|---|---|---|
| EBITA | 8.1% | 8.3% | 9.1% | 9.6% | 10.1% | 10.6% | 11.1% |
| 6.2% | 6,488 | **(3,416)** | **(11,814)** | **(19,024)** | **(25,281)** | **(30,760)** | **(35,599)** |
| 6.7% | 17,293 | 6,501 | **(2,651)** | **(10,508)** | **(17,327)** | **(23,299)** | **(28,573)** |
| 7.2% | 28,099 | 16,418 | 6,512 | **(1,992)** | **(9,373)** | **(15,837)** | **(21,546)** |
| 7.7% | 38,904 | 26,334 | 15,676 | 6,524 | **(1,419)** | **(8,376)** | **(14,520)** |
| 8.2% | 49,710 | 36,251 | 24,839 | **15,040** | 6,535 | **(914)** | **(7,493)** |
| 8.7% | 60,515 | 46,168 | 34,002 | 23,555 | 14,489 | 6,547 | **(467)** |
| 9.2% | 71,321 | 56,085 | 43,165 | 32,071 | 22,443 | 14,009 | 6,560 |
| 9.7% | 82,126 | 66,002 | 52,329 | 40,587 | 30,397 | 21,470 | 13,586 |
| 10.2% | 92,932 | 75,919 | 61,492 | 49,103 | 38,351 | 28,931 | 20,613 |

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

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## 12. Goodwill continued

**Care** continued

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

| | Long-term growth rate | | | | | | |
|---|---|---|---|---|---|---|---|
| EBITA | 1.75% | 2.00% | 2.25% | 2.50% | 2.75% | 3.00% | 3.25% |
| 7.2% | **(9,669)** | **(7,278)** | **(4,725)** | **(1,992)** | 940 | 4,095 | 7,498 |
| 7.4% | **(5,731)** | **(3,241)** | **(581)** | 2,266 | 5,320 | 8,606 | 12,151 |
| 7.7% | **(1,793)** | 797 | 3,563 | 6,524 | 9,701 | 13,118 | 16,805 |
| 7.9% | 2,145 | 4,834 | 7,707 | 10,782 | 14,081 | 17,630 | 21,458 |
| 8.2% | 6,083 | 8,872 | 11,851 | **15,040** | 18,461 | 22,142 | 26,112 |
| 8.4% | 10,020 | 12,909 | 15,995 | 19,298 | 22,841 | 26,653 | 30,766 |
| 8.7% | 13,958 | 16,947 | 20,139 | 23,555 | 27,221 | 31,165 | 35,419 |
| 8.9% | 17,896 | 20,984 | 24,283 | 27,813 | 31,602 | 35,677 | 40,073 |
| 9.2% | 21,834 | 25,022 | 28,427 | 32,071 | 35,982 | 40,189 | 44,727 |

It is only when a simultaneous unfavourable change of greater than approximately 0.5% occurs in both the long-term growth rate and EBITA margin that the headroom falls below zero.

## 13. 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 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 1 January 2013 | 58,744 | 13,549 | 72,293 | 5,190 | 224 | 5,414 | 77,707 |
| Acquired on acquisition | 2,552 | 4,551 | 7,103 | — | — | — | 7,103 |
| Additions | — | — | — | 1,169 | — | 1,169 | 1,169 |
| Disposal of subsidiary | — | — | — | (173) | — | (173) | (173) |
| **At 31 December 2013** | **61,296** | **18,100** | **79,396** | **6,186** | **224** | **6,410** | **85,806** |
| **Accumulated amortisation** | | | | | | | |
| 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 1 January 2013 | 26,826 | 9,150 | 35,976 | 2,188 | 178 | 2,366 | 38,342 |
| Amortisation charge for period | 8,600 | 2,260 | 10,860 | 1,046 | 46 | 1,092 | 11,952 |
| Disposal of subsidiary | — | — | — | (134) | — | (134) | (134) |
| **At 31 December 2013** | **35,426** | **11,410** | **46,836** | **3,100** | **224** | **3,324** | **50,160** |
| **Carrying amount** | | | | | | | |
| **At 31 December 2013** | **25,870** | **6,690** | **32,560** | **3,086** | **—** | **3,086** | **35,646** |
| At 31 December 2012 | 31,918 | 4,399 | 36,317 | 3,002 | 46 | 3,048 | 39,365 |

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## 13. Other intangible assets continued

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 3.6 years (2012: 3.7 years).

Intellectual property is amortised over its useful economic life of 5.0 years.

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

## 14. Property, plant and equipment

| | Freehold property £'000 | Leasehold improvements £'000 | Plant and machinery £'000 | Fixtures, fittings and equipment £'000 | Motor vehicles £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| **Gross carrying amount** | | | | | | |
| At 1 January 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 1 January 2013 | — | 9,478 | 5,062 | 39,998 | 1,223 | 55,761 |
| Acquired on acquisition | — | 141 | — | 1,266 | 162 | 1,569 |
| Additions | 110 | 576 | 244 | 3,267 | 18 | 4,215 |
| Disposals | — | (159) | (1,093) | (11,902) | (77) | (13,231) |
| Disposal of subsidiary | — | (423) | (120) | (1,920) | — | (2,463) |
| **At 31 December 2013** | **110** | **9,613** | **4,093** | **30,709** | **1,326** | **45,851** |
| **Depreciation** | | | | | | |
| 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 1 January 2013 | — | 5,003 | 3,742 | 29,912 | 1,123 | 39,780 |
| Acquired on acquisition | — | 99 | — | 997 | 103 | 1,199 |
| Provided in the year | — | 1,209 | 509 | 3,156 | 50 | 4,924 |
| Eliminated on disposals | — | (116) | (1,095) | (11,744) | (55) | (13,010) |
| Disposal of subsidiary | — | (228) | (101) | (1,781) | — | (2,110) |
| **At 31 December 2013** | **—** | **5,967** | **3,055** | **20,540** | **1,221** | **30,783** |
| **Carrying amount** | | | | | | |
| **At 31 December 2013** | **110** | **3,646** | **1,038** | **10,169** | **105** | **15,068** |
| At 31 December 2012 | — | 4,475 | 1,320 | 10,086 | 100 | 15,981 |

# Notes to the financial statements – Group continued

For the year ended 31 December 2013

## 15. Investments

The principal undertakings within the Group at 31 December 2013 are shown below:

| | Proportion held | Country of registration | Nature of business |
|---|---|---|---|
| Mears Limited | 100% | England and Wales | Provision of maintenance services |
| Scion Technical Services Limited | 100% | England and Wales | Provision of maintenance services |
| Scion Estates Limited | 100% | England and Wales | Provision of grounds maintenance |
| Jackson Lloyd Limited | 100% | England and Wales | Provision of maintenance services |
| Morrison Facilities Services Limited | 100% | Scotland | Provision of maintenance services |
| Morrison Scotland LLP | 66.67% | Scotland | Provision of maintenance services |
| Manchester Working Limited | 80% | England and Wales | Provision of maintenance services |
| Mears Home Improvements Limited | 100% | England and Wales | Provision of maintenance services |
| Mears Care Limited | 100% | England and Wales | Provision of care |
| Mears Care (Northern Ireland) Limited | 100% | Northern Ireland | Provision of care |
| Mears Care (Scotland) Limited | 100% | Scotland | Provision of care |
| Independent Living Services (ILS) Limited | 100% | Scotland | Provision of care |
| Nurseplus Limited | 100% | Scotland | Provision of care |
| Terraquest Solutions Limited | 100% | England and Wales | Provision of professional services |
| Mears Insurance Company Limited | 99.99% | Guernsey | Provision of insurance services |

All material subsidiary undertakings with the exception of Manchester Working Limited prepare accounts to 31 December. Manchester Working Limited prepares accounts to 31 March in line with the minority shareholder.

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

## 16. Inventories

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Materials and consumables | **3,773** | 2,634 |
| Work in progress | **6,679** | 9,199 |
| | **10,452** | 11,833 |

The Group consumed inventories totalling £641.1m during the year (2012: £495.6m). No items are being carried at fair value less costs to sell (2012: £nil).

## 17. Trade and other receivables

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Current assets: | | |
| – trade receivables | **44,322** | 69,416 |
| – amounts recoverable on construction contracts | **—** | 6,395 |
| – amounts recoverable on non-construction contracts | **95,046** | 92,927 |
| – prepayments and accrued income | **11,914** | 11,532 |
| – current tax assets | **411** | — |
| | **151,693** | 180,270 |
| Non-current assets: | | |
| – trade receivables | **—** | 2,798 |
| Total trade and other receivables | **151,693** | 183,068 |

Trade receivables are normally due within 30 to 60 days and do not bear any effective interest rate. All trade receivables and accrued income are subject to credit risk exposure. Social Housing customers are typically Local Authorities and Housing Associations where credit risk is minimal. Care customers are typically County Councils where credit risk is minimal.

The ageing analysis of trade receivables is as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Neither impaired nor past due | **39,501** | 56,096 |
| Less than three months past due but not impaired | **2,906** | 10,926 |
| More than three months but not impaired | **1,915** | 5,192 |
| Total trade and other receivables | **44,322** | 72,214 |

## 18. Trade and other payables

| | 2013 £'000 | 2012 (restated) £'000 |
|---|---|---|
| Trade payables | **100,692** | 102,567 |
| Accruals and deferred income | **69,708** | 78,280 |
| Social security and other taxes | **21,804** | 23,329 |
| Payments on account for construction contract work | **—** | 1,044 |
| Payments on account for non-construction contract work | **923** | 520 |
| Other creditors | **3,848** | 7,768 |
| | **196,975** | 213,508 |

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

Included in other creditors is £0.6m (2012: £0.5m) relating to contingent consideration on acquisitions.

A prior year adjustment totalling £14.2m relates to reductions to the estimated fair value of assets acquired. The reduction in fair value of assets acquired relates to costs not accrued at the time of the acquisition and an increase to an onerous contract accrual. The revisions are considered sufficiently material to warrant the restatement of the prior year provisional balances.

# Notes to the financial statements – Group continued

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## 19. Financing liabilities

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Current liabilities: | | |
| – interest rate swaps | **478** | 711 |
| | **478** | 711 |
| Non-current liabilities: | | |
| – interest rate swaps | **701** | 1,823 |
| Total financing liabilities | **1,179** | 2,534 |

## 20. Long-term other liabilities

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Other creditors | **1,278** | 879 |

Included in other creditors is £1.3m (2012: £0.9m) 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**

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| **Financial assets** | | |
| **Loans and receivables** | | |
| Trade receivables | **44,322** | 72,214 |
| Amounts recoverable on contracts | **95,046** | 99,322 |
| Cash at bank and in hand | **79,552** | 57,616 |
| | **218,920** | 229,152 |
| **Financial liabilities** | | |
| **Fair value (level 2)** | | |
| Interest rate swaps – effective | **(1,179)** | (2,534) |
| **Fair value (level 3)** | | |
| Deferred and contingent consideration in respect of acquisitions | **(1,836)** | (1,501) |
| **Amortised cost** | | |
| Bank borrowings and overdrafts | **(80,000)** | (70,000) |
| Trade payables | **(100,692)** | (102,567) |
| Accruals and deferred income | **(69,708)** | (64,190) |
| Other creditors | **(3,848)** | (7,768) |
| | **(257,263)** | (248,560) |
| | **(38,343)** | (19,408) |

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## 21. Financial instruments continued

### Categories of financial instruments continued

The IFRS 7 hierarchy level categorisation relates to the extent the fair value can be determined by reference to comparable market values. The classifications range from level 1, where instruments are quoted on an active market, through to level 3, where the assumptions used to arrive at fair value do not have comparable market data.

The fair values of interest rate swaps have been calculated by a third party expert discounting estimated future cash flows on the basis of market expectations of future interest rates (level 2).

The fair values of deferred and contingent consideration have been calculated by the Directors by reference to expected future income and expenditure in respect of the acquired businesses.

There have been no transfers between levels during the year.

### Fair value information

The fair value of the Group's financial assets and liabilities is as disclosed above and approximates to the book value.

### Financial risk management

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

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

### Borrowing facilities

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

The Group had total borrowing facilities of £120.0m with Barclays Bank PLC and HSBC plc, of which £80.0m was utilised at 31 December 2013.

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 2013 were a £30.0m 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 rate fluctuations on borrowings is managed through the use of interest rate swaps; hence the fixed rate borrowings relate to floating rate loans where the interest rate has been fixed by a hedging arrangement. The fair value of interest rate exposure on financial liabilities of the Group as at 31 December 2013 was:

| | Interest rate | | | |
|---|---|---|---|---|
| | Fixed £'000 | Floating £'000 | Zero £'000 | Total £'000 |
| **Financial liabilities – 2013** | **55,000** | **25,000** | **1,836** | **81,836** |
| Financial liabilities – 2012 | 55,000 | 15,000 | 1,501 | 71,501 |

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.

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## 21. Financial instruments continued

**Interest rate risk management** continued

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

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Nominal amount hedged £'000 | Applicable interest rates % | Nominal amount hedged £'000 | Applicable interest rates % |
| Within one year | — | — | — | — |
| One to two years | — | — | — | — |
| Two to five years | 55,000 | 1.95% | 55,000 | 1.95% |
| More than five years | — | — | — | — |

### Effective interest rates

Interest rate swaps with fair value liabilities of £1.2m (2012: £2.5m) and remaining lives of two years and eight months have been accounted for in financing liabilities.

The Group's overall average cost of debt, including effective and ineffective interest rate swaps, is 3.1% as at 31 December 2013 (2012: 3.3%). Excluding these swaps the average is 2.2% (2012: 2.6%).

### 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 expire in August 2016.

Movements during the year were:

| | £'000 |
|---|---|
| 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 1 January 2013 | (1,913) |
| Amounts transferred to the Consolidated Income Statement | 791 |
| Revaluations during the year | 593 |
| Deferred tax movement | (319) |
| **At 31 December 2013** | **(848)** |

At 31 December 2013 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 2013 and reserves would decrease or increase, respectively, by £0.2m.

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### 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 |
|---|---|---|---|---|---|
| **2013** | | | | | |
| **Non-derivative financial liabilities:** | | | | | |
| Bank borrowings | **25,000** | **—** | **55,000** | **—** | **80,000** |
| Contingent consideration in respect of acquisitions | **557** | **1,279** | **—** | **—** | **1,836** |
| **Derivative financial liabilities:** | | | | | |
| Interest rate swaps – effective | **478** | **401** | **300** | **—** | **1,179** |
| **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 |

The Group has disclosed core bank borrowings of £55.0m 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.

### Credit risk management

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

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

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

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## 21. Financial instruments continued

### Credit risk management continued

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.

### Deferred and contingent consideration

The table below shows the movements in deferred and contingent consideration:

| | Total £'000 |
|---|---|
| At 1 January 2012 | 2,861 |
| Released to operating profit on reassessment of contingent consideration | (1,400) |
| Unwinding of discounting | 40 |
| At 1 January 2013 | 1,501 |
| Increase due to new acquisitions in the year | 500 |
| Paid in respect of acquisitions | (204) |
| Unwinding of discounting | 39 |
| **At 31 December 2013** | **1,836** |

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 management

The Group's objectives when managing capital are:

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

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

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

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Cash and cash equivalents is comprised as follows: | | |
| – cash at bank and in hand | **79,552** | 57,616 |
| – bank borrowings and overdrafts | **(80,000)** | (70,000) |
| Cash and cash equivalents | **(448)** | (12,384) |

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## 22. Deferred taxation

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

### Deferred tax asset

The following deferred tax assets were recognised by the Group as at 31 December 2013:

| | Pension scheme £'000 | Share-based payments £'000 | Cash flow hedges £'000 | Tax losses £'000 | Short-term temporary differences £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| 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 to Consolidated Statement of Changes in Equity | — | (2,607) | — | — | — | (2,607) |
| Credit to Consolidated Statement of Comprehensive Income | 374 | — | 151 | — | — | 525 |
| At 1 January 2013 | 1,321 | 2,801 | 571 | 7,134 | 3,601 | 15,428 |
| Acquired on acquisition | — | — | — | — | 209 | 209 |
| Debit to Income Statement | (188) | (594) | — | (3,276) | (241) | (4,299) |
| Debit to Consolidated Statement of Changes in Equity | — | (599) | — | — | — | (599) |
| Credit/(debit) to Consolidated Statement of Comprehensive Income | 150 | — | (319) | — | — | (169) |
| **At 31 December 2013** | **1,283** | **1,608** | **252** | **3,858** | **3,569** | **10,570** |

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 is credited directly to equity, even though the grants themselves are not accounted for within the Income Statement.

In addition to those recognised above, unused tax losses totalling £25.5m (2012: £25.3m) have not been recognised as the Directors do not consider that it is probable that they will be recovered.

The following deferred tax liabilities were recognised by the Group as at 31 December 2013:

### Deferred tax liabilities

| | Pension scheme £'000 | Acquisition intangibles £'000 | Short-term temporary differences £'000 | Total £'000 |
|---|---|---|---|---|
| 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 1 January 2013 | 3,225 | 8,263 | — | 11,488 |
| Acquired on acquisition | — | 1,582 | — | 1,582 |
| (Credit)/charge to Income Statement | 295 | (3,174) | — | (2,879) |
| Credit to Consolidated Statement of Comprehensive Income | (427) | — | — | (427) |
| **At 31 December 2013** | **3,093** | **6,671** | **—** | **9,764** |



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## 22. Deferred taxation continued

### Deferred tax liabilities continued

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

Share capital represents the nominal value of shares that have been issued.

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

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

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

The merger reserve relates to the difference between the nominal value and total consideration in respect of acquisitions, where the Company was entitled to the merger relief offered by the Companies Act.

### Share capital

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| **Allotted, called up and fully paid** | | |
| At 1 January 91,859,911 (2012: 85,658,763) ordinary shares of 1p each | **919** | 857 |
| Issue of nil (2012: 2,833,489) shares on acquisition of Morrison Facilities Services Limited | **—** | 28 |
| Issue of 6,368,069 shares as a share placement | **64** | — |
| Issue of 2,433,670 (2012: 3,367,659) shares on exercise of share options | **24** | 34 |
| At 31 December 100,661,649 (2012: 91,859,911) ordinary shares of 1p each | **1,007** | 919 |

During the year, 2,433,670 (2012: 3,367,659) 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 £2.1m has been credited to the share premium account.

During the year 6,368,069 ordinary 1p shares were issued in respect of a share placement with the difference between the nominal value of £0.06m and the total consideration of £19.1m being credited to the share premium account.

During the prior 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.

## 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:

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Depreciation | **4,748** | 3,444 |
| Loss on disposal of property, plant and equipment | **215** | 16 |
| Amortisation | **11,904** | 8,856 |
| Share-based payments | **665** | 250 |
| IAS 19 pension movement | **(2,538)** | (1,416) |
| Finance income | **(2)** | (11) |
| Finance cost | **3,566** | 2,618 |
| Total | **18,558** | 13,757 |

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## 25. Acquisitions and disposals

On 19 April 2013 the Group acquired the entire issued share capital of ILS Group Limited for a total consideration of £8.3m which was satisfied in cash. On 16 May 2013 the Group acquired the entire issued share capital of Helcim Group Limited for a total consideration of £0.5m which was entirely deferred and is payable over the following five years. The effect of the acquisition on the Group's assets was as follows:

| | Book and provisional fair value | | |
|---|---|---|---|
| | ILS Group Limited £'000 | Helcim Group Limited £'000 | Total £'000 |
| **Assets** | | | |
| **Non-current** | | | |
| Property, plant and equipment | 366 | 5 | 371 |
| Deferred tax asset | 209 | — | 209 |
| Current | | | |
| Trade receivables | 1,194 | 1,066 | 2,260 |
| Other receivables | 515 | 701 | 1,216 |
| **Total assets** | 2,284 | 1,772 | 4,056 |
| **Liabilities** | | | |
| **Current** | | | |
| Short-term borrowings and overdrafts | 14,779 | 330 | 15,109 |
| Trade and other payables | 1,746 | 3,494 | 5,240 |
| **Total liabilities** | 16,525 | 3,824 | 20,349 |
| Net assets acquired | (14,241) | (2,052) | (16,293) |
| Intangibles capitalised | 4,551 | 2,552 | 7,103 |
| Deferred tax liability recognised in respect of intangibles capitalised | (1,046) | (536) | (1,582) |
| Goodwill capitalised | 19,040 | 536 | 19,576 |
| | 8,304 | 500 | 8,804 |
| Satisfied by: | | | |
| – cash | 8,304 | — | 8,304 |
| – deferred consideration | — | 500 | 500 |
| | 8,304 | 500 | 8,804 |

The ILS Group Limited intangible asset is recognised and valued at £4.6m. This represents the expected value to be derived from the acquired customer related contracts and associated relationships and the Nurseplus trademark. 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 12.2% which the Directors consider is commensurate with the risks associated with capturing returns from the customer relationships. The estimated life for customer contracts is assumed to be the average remaining period of the contracts over which earnings from the customer relationships are expected to be generated of three years. The estimated life for the Nurseplus trademark has been based upon the age, history and profile of the trademark and is estimated to be ten years.

The Directors consider that the value assigned to goodwill represents the workforce acquired and the access to new markets and to additional geographical areas in the UK as a result of this acquisition.

The Helcim Group Limited intangible asset is recognised and valued at £2.4m. This represents the expected value to be derived from the acquired customer related contracts and the acquired contracts with property landlords.

In the period ended 31 December 2013, the ILS Group Limited acquisition contributed revenue of £17.2m and a £1.5m operating profit before amortisation of acquisition intangibles.

In the period ended 31 December 2013, the Helcim Group Limited acquisition contributed revenue of £4.6m and a £0.4m operating loss before amortisation of acquisition intangibles.

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## 25. Acquisitions and disposals continued

For the year ended 31 December 2013, had the acquisitions taken place on 1 January 2013, the combined Group full-year revenue for the year is estimated at £874.2m and the combined Group profit on continuing operations for the year before taxation is estimated at £17.3m.

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

| | Total £'000 |
|---|---|
| Cash consideration | 8,304 |
| Short-term borrowings and overdrafts | 15,109 |
| Cash payments in respect of prior year acquisitions | 204 |
| | 23,617 |

Following the acquisition, part of the proceeds from a share placement were used to settle the acquired borrowings.

On 5 November 2013 the Group entered into a sale agreement to dispose of Haydon Mechanical & Electrical Limited, which undertook design and build M&E services. The disposal was completed on 21 November 2013. The effect of the disposal on the Group's assets was as follows:

| | Total £'000 |
|---|---|
| **Assets** | |
| **Non-current** | |
| Intangible assets | 39 |
| Property, plant and equipment | 352 |
| Current | |
| Inventories | 90 |
| Trade receivables | 26,479 |
| Other receivables | 109 |
| Cash at bank and in hand | 1,453 |
| **Total assets** | 28,522 |
| **Liabilities** | |
| **Current** | |
| Trade and other payables | 10,069 |
| **Total liabilities** | 10,069 |
| Net assets disposed | 18,453 |
| Loss on disposal | 18,453 |

Analysis of net outflow in respect of the disposal of the subsidiary undertaking:

| | Total £'000 |
|---|---|
| Cash at bank and in hand disposed of | 1,453 |

## 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 £1.5m (2012: £1.5m) to these schemes.

### IAS 19 'Employee Benefits'

The Group contributes to 32 (2012: 30) principal defined benefit schemes on behalf of a number of employees which require contributions to be made to separately administered funds.

These pension schemes are operated on behalf of Mears Limited, Mears Care Limited, Morrison Facilities Services Limited and their subsidiary undertakings. The assets of the schemes are administered by trustees in funds independent from the assets of the Group.

In certain cases, the Group will participate under Admitted Body status in the Local Government Pension Scheme. The Group will contribute for a finite period up until the end of the particular contract. The Group is required to pay regular contributions as detailed in the scheme's schedule of contributions. In some cases these contributions are capped and any excess can be recovered from the body from which the employees originally transferred. Where the 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 114. 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 page 115.

The disclosures in respect of the two (2012: two) Group defined benefit schemes and the 30 (2012: 28) other defined benefit schemes in this note have been aggregated.

Costs and liabilities of the schemes are based on actuarial valuations. The latest full actuarial valuations for the schemes were updated to 31 December 2013 by qualified independent actuaries using the projected unit method.

IAS 19 (revised) 'Employee Benefits' is applicable for accounting periods beginning on or after 1 January 2013 and so has been applied for the first time. 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 are based on the discount rate instead of the expected rate of return on assets. This change in accounting standards has resulted in the restatement of the prior year results and as a result the comparatives presented on pages 113 to 116 are restated in respect of this change.

The change has resulted in a lower expected return in the Consolidated Income Statement and a higher gain in the Consolidated Statement of Comprehensive Income. The effect on the Consolidated Income Statement for 2012 is an increase in operating costs of £0.3m and a decrease in finance income of £2.3m. There is a corresponding decrease in the actuarial loss recognised in the Statement of Consolidated Income of £2.6m. There is no change to scheme assets or liabilities.

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

| | **2013** | 2012 |
|---|---|---|
| Rate of increase of salaries – first two years term | **1.00%** | 1.00% |
| Rate of increase of salaries – long term | **3.35%** | 2.85% |
| Rate of increase for pensions in payment – based on CPI with a cap of 5% | **2.45%** | 2.20% |
| Rate of increase for pensions in payment – based on RPI with a cap of 5% | **3.25%** | 2.80% |
| Rate of increase for pensions in payment – based on CPI with a cap of 3% | **2.10%** | 1.90% |
| Rate of increase for pensions in payment – based on RPI with a cap of 3% | **2.55%** | 2.20% |
| Discount rate | **4.60%** | 4.70% |
| Retail Price Inflation | **3.35%** | 2.85% |
| Consumer Price Inflation | **2.45%** | 2.15% |
| Life expectancy for a 65 year old male | **21.7 years** | 21.4 years |
| Life expectancy for a 65 year old female | **24.1 years** | 23.8 years |

# Notes to the financial statements – Group continued

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## 26. Pensions continued

### IAS 19 'Employee Benefits' continued

The amounts recognised in the Balance Sheet and major categories of plan assets are:

| | 2013 | | | 2012 (restated) | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Other Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Equities | 50,449 | 201,661 | 252,110 | 38,576 | 185,592 | 224,168 |
| Bonds | 44,800 | 68,236 | 113,036 | 44,390 | 64,862 | 109,252 |
| Guarantee | — | 785 | 785 | — | 3,172 | 3,172 |
| Property | 347 | 19,478 | 19,825 | 1,136 | 18,119 | 19,255 |
| Cash | 3,314 | 34,563 | 37,877 | 5,635 | 15,287 | 20,922 |
| Group's estimated asset share | 98,910 | 324,723 | 423,633 | 89,737 | 287,032 | 376,769 |
| Present value of funded scheme liabilities | (88,195) | (295,641) | (383,836) | (79,336) | (260,868) | (340,204) |
| Funded status | 10,715 | 29,082 | 39,797 | 10,401 | 26,164 | 36,565 |
| Scheme surpluses not recognised as assets | — | (31,173) | (31,173) | — | (28,283) | (28,283) |
| Pension asset/(liability) | 10,715 | (2,091) | 8,624 | 10,401 | (2,119) | 8,282 |

The amounts recognised in the Income Statement are as follows:

| | 2013 | | | 2012 (restated) | | |
|---|---|---|---|---|---|---|
| | Other Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Current service cost | 2,021 | 5,860 | 7,881 | 563 | 3,434 | 3,997 |
| Past service cost | — | 393 | 393 | — | — | — |
| Administration costs | 568 | 150 | 718 | 162 | 82 | 244 |
| Curtailment | — | 15 | 15 | — | — | — |
| Total operating charge | 2,589 | 6,418 | 9,007 | 725 | 3,516 | 4,241 |
| Net interest | (565) | (1,151) | (1,716) | 161 | (801) | (640) |
| Total charged to the result for year | 2,024 | 5,267 | 7,291 | 886 | 2,715 | 3,601 |

Cumulative actuarial gains and losses recognised in equity are as follows:

| | 2013 | | | 2012 (restated) | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| On TUPE transfer of employees | — | (136) | (136) | — | 19,557 | 19,557 |
| Return on plan assets below that recorded in net interest | 3,796 | 25,804 | 29,600 | 695 | 3,991 | 4,686 |
| Actuarial gain/(loss) arising from changes in demographic assumptions | 1,040 | (611) | 429 | — | — | — |
| Actuarial loss arising from changes in financial assumptions | (6,879) | (23,770) | (30,649) | (342) | (1,676) | (2,018) |
| Actuarial gain/(loss) arising from liability experience | 932 | 518 | 1,450 | — | (143) | (143) |
| Effects of limitation of recognisable surplus | — | (2,890) | (2,890) | — | (21,752) | (21,752) |
| Total gains and losses recognised in equity | (1,111) | (1,085) | (2,196) | 353 | (23) | 330 |
| At 1 January | (1,027) | (6,456) | (7,483) | (1,380) | (6,433) | (7,813) |
| Total at 31 December | (2,138) | (7,541) | (9,679) | (1,027) | (6,456) | (7,483) |

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## 26. Pensions continued

### IAS 19 'Employee Benefits' continued

Changes in the present value of the defined benefit obligations are as follows:

| | 2013 | | | 2012 (restated) | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Present value of obligations at 1 January | 79,336 | 260,868 | 340,204 | 13,098 | 68,827 | 81,925 |
| Current service cost | 2,021 | 5,860 | 7,881 | 563 | 3,434 | 3,997 |
| Past service cost | — | 393 | 393 | — | — | — |
| Scheme administration costs | — | 71 | 71 | — | 53 | 53 |
| Interest on obligations | 3,682 | 12,096 | 15,778 | 1,259 | 5,739 | 6,998 |
| Plan participants' contributions | 524 | 2,189 | 2,713 | 159 | 1,261 | 1,420 |
| Benefits paid | (2,275) | (6,069) | (8,344) | (895) | (2,180) | (3,075) |
| Contract transfer | — | (3,645) | (3,645) | — | 32,474 | 32,474 |
| Acquisitions | — | — | — | 64,810 | 149,441 | 214,251 |
| Curtailments | — | 15 | 15 | — | — | — |
| Actuarial (gain)/loss arising from changes in demographic assumptions | (1,040) | 611 | (429) | — | — | — |
| Actuarial loss arising from changes in financial assumptions | 6,879 | 23,770 | 30,649 | 342 | 1,676 | 2,018 |
| Actuarial (gain)/loss arising from liability experience | (932) | (518) | (1,450) | — | 143 | 143 |
| Present value of obligations at 31 December | 88,195 | 295,641 | 383,836 | 79,336 | 260,868 | 340,204 |

Changes in the fair value of the plan assets are as follows:

| | 2013 | | | 2012 (restated) | | |
|---|---|---|---|---|---|---|
| | Group schemes £'000 | Other schemes £'000 | Total £'000 | Group schemes £'000 | Other schemes £'000 | Total £'000 |
| Fair value of plan assets at 1 January | 89,737 | 287,032 | 376,769 | 8,305 | 74,310 | 82,615 |
| Expected return on plan assets | 4,247 | 13,247 | 17,494 | 1,098 | 6,540 | 7,638 |
| Employers' contributions | 3,449 | 6,380 | 9,829 | 1,556 | 3,461 | 5,017 |
| Plan participants' contributions | 524 | 2,189 | 2,713 | 159 | 1,261 | 1,420 |
| Benefits paid | (2,275) | (6,069) | (8,344) | (895) | (2,180) | (3,075) |
| Scheme administration costs | (568) | (79) | (647) | (162) | (29) | (191) |
| Contract transfer | — | (3,781) | (3,781) | — | 45,921 | 45,921 |
| Acquisitions | — | — | — | 78,981 | 153,757 | 232,738 |
| Return on plan assets above that recorded in net interest | 3,796 | 25,804 | 29,600 | 695 | 3,991 | 4,686 |
| Fair value of plan assets at 31 December | 98,910 | 324,723 | 423,633 | 89,737 | 287,032 | 376,769 |

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## 26. Pensions continued

**IAS 19 'Employee Benefits'** continued

History of experience gains and losses are as follows:

| | Group schemes | | | | |
|---|---|---|---|---|---|
| | **2013 £'000** | 2012 (restated) £'000 | 2011 £'000 | 2010 £'000 | 2009 £'000 |
| Fair value of scheme assets | **98,910** | 89,737 | 8,305 | 7,694 | 1,783 |
| Net present value of defined benefit obligations | **(88,195)** | (79,336) | (13,097) | (13,112) | (2,231) |
| Net surplus/(deficit) | **10,715** | 10,401 | (4,792) | (5,418) | (448) |
| **Experience adjustments arising on scheme assets** | | | | | |
| Amount | **3,796** | 695 | (711) | (20) | 186 |
| Percentage of scheme assets | **3.8%** | 0.8% | (8.6%) | (0.3%) | 10.4% |
| **Experience adjustments arising on scheme liabilities** | | | | | |
| Amount | **(932)** | — | (21) | (21) | (79) |
| Percentage of scheme liabilities | **(1.1%)** | — | (0.2%) | (0.2%) | (3.5%) |

| | Other schemes | | | | |
|---|---|---|---|---|---|
| | **2013 £'000** | 2012 (restated) £'000 | 2011 £'000 | 2010 £'000 | 2009 £'000 |
| Fair value of scheme assets | **324,723** | 286,328 | 74,310 | 75,995 | 62,442 |
| Net present value of defined benefit obligations | **(295,641)** | (260,689) | (68,828) | (77,725) | (64,775) |
| Net surplus/(deficit) | **29,082** | 25,639 | 5,482 | (1,730) | (2,333) |
| Asset value not recognised as surplus | **(31,172)** | (27,758) | (6,530) | (545) | (424) |
| Net deficit | **(2,091)** | (2,119) | (1,048) | (2,275) | (2,757) |
| **Experience adjustments arising on scheme assets** | | | | | |
| Amount | **25,805** | 3,991 | (11,759) | 3,521 | 9,561 |
| Percentage of scheme assets | **7.9%** | 1.4% | (15.8%) | 4.6% | 15.3% |
| **Experience adjustments arising on scheme liabilities** | | | | | |
| Amount | **(518)** | 143 | 8,521 | 397 | 1,443 |
| Percentage of scheme liabilities | **(0.2%)** | 0.1% | 12.4% | 0.5% | 2.2% |

The employers' contributions expected to be paid during the financial year ending 31 December 2014 amount to £9.2m.

## 27. Operating lease commitments

Non-cancellable operating lease rentals payable were as follows:

| | Land and buildings | | Other | |
|---|---|---|---|---|
| | **2013 £'000** | 2012 £'000 | **2013 £'000** | 2012 £'000 |
| **Payable** | | | | |
| Within one year | **2,512** | 3,270 | **15,010** | 15,029 |
| Between two and five years | **5,398** | 7,885 | **15,768** | 23,726 |
| After more than five years | **1,964** | 2,982 | **—** | — |

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 2013 or at 31 December 2012.

## 29. Contingent liabilities

The Group has guaranteed that it will complete certain contracts that it has commenced. At 31 December 2013 these guarantees amounted to £20.4m (2012: £10.8m).

The Group had no other contingent liabilities at 31 December 2013 or at 31 December 2012.

## 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:

| | **2013 %** | 2012 % |
|---|---|---|
| Directors | **0.4** | 0.4 |

Key management personnel's compensation is as follows:

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Salaries | **2,645** | 2,025 |
| Contributions to defined contribution pension schemes | **185** | 185 |
| Share-based payments | **50** | 50 |
| | **3,080** | 2,260 |

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 (2012: £0.01m). At 31 December 2013 the Group was owed £0.02m (2012: £0.01m) by Asert LLP.

During the year the Group also purchased call centre related services from Mears 24/7 LLP, a company in which Mears Limited is a 50% partner, totalling £1.9m (2012: £2.1m). The Group also recharged costs totalling £0.8m to Mears 24/7 LLP at cost. At 31 December 2013 the Group owed £0.3m (2012: £0.1) to Mears 24/7 LLP.

During the year the Group purchased strategic advice services from OC&C Services Limited, a Company related by common Directorship, of £0.2m (2012: £nil). At 31 December 2013 the Group owed £nil (2012: £nil) to OC&C Services Limited.

# Principal accounting policies – Company

## Basis of preparation

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

The principal accounting policies of the Company are set out below. The following accounting policies have remained unchanged from the previous year.

## Investments

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

## Goodwill

Goodwill representing the reallocation of amounts previously classed as investments upon the hive across of trade and assets is capitalised and amortised on a straight-line basis over its estimated useful economic life.

## Share-based employee remuneration

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

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

Share-based remuneration in respect of employees of the Company is ultimately recognised as an expense in the Profit and loss account with a corresponding credit to share-based payment reserve.

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

The Company's financial liabilities are overdrafts, other creditors and contingent consideration. They are included in the Balance Sheet line items 'Creditors: amounts falling due within one year' and 'Creditors: amounts falling due after more than one year'.

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

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

Contingent consideration is initially recognised at fair value and is subsequently measured at fair value through the Profit and Loss Account.

### Derivative financial instruments

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

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

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

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

### Hedge accounting for interest rate swaps

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

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

# Parent Company balance sheet

As at 31 December 2013

| | Note | 2013 £'000 | 2012 £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Intangible assets: goodwill | 5 | **1,938** | 2,907 |
| Investments | 6 | **80,123** | 73,197 |
| | | **82,061** | 76,104 |
| **Current assets** | | | |
| Debtors | 7 | **96,972** | 76,664 |
| Cash at bank and in hand | | **—** | 963 |
| | | **96,972** | 77,627 |
| **Creditors:** amounts falling due within one year | 8 | **(30,077)** | (17,759) |
| **Net current assets** | | **66,895** | 59,868 |
| **Total assets less current liabilities** | | **148,956** | 135,972 |
| **Creditors:** amounts falling due after more than one year | 9 | **(55,879)** | (55,879) |
| **Provisions for liabilities** | | | |
| Pension liability | 14 | **(3,173)** | (2,789) |
| | | **89,904** | 77,304 |
| **Capital and reserves** | | | |
| Called up share capital | 10 | **1,007** | 919 |
| Share premium account | 11 | **56,082** | 34,910 |
| Share-based payment reserve | 11 | **1,050** | 1,685 |
| Hedging reserve | 11 | **(848)** | (1,913) |
| Profit and loss account | 11 | **32,613** | 41,703 |
| **Equity shareholders' funds** | | **89,904** | 77,304 |

The financial statements were approved by the Board of Directors on 28 March 2014.

**R Holt**
**Director**

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

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

# Notes to the financial statements – Company



## 1. Profit for the financial year

The Parent Company has taken advantage of Section 408 of the Companies Act 2006 and has not included its own profit and loss account in these financial statements. The Group profit for the year includes a loss of £1.2m (2012: profit of £11.9m) which is dealt with in the financial statements of the Company. This result is stated after charging auditor's remuneration of £56,000 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:

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Wages and salaries | **1,963** | 1,273 |
| Social security costs | **5,139** | 752 |
| Other pension costs | **185** | 185 |
| | **7,287** | 2,210 |

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

| | **2013 Number** | 2012 Number |
|---|---|---|
| Office and management | **11** | 11 |

## 3. Share-based employee remuneration

As at 31 December 2013 the Group maintained five 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 2013 (2012: £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:

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Final 2012 dividend of 5.70p (2012: final 2011 dividend of 5.35p) per share | **5,617** | 4,698 |
| Interim 2013 dividend of 2.50p (2012: interim 2012 dividend of 2.30p) per share | **2,499** | 2,041 |
| | **8,116** | 6,739 |

The proposed final 2013 dividend of 6.30p per share has not been included within the financial statements as no obligation existed at 31 December 2013.

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# Notes to the financial statements – Company continued

## 5. Goodwill

| | Goodwill £'000 |
|---|---|
| **Cost** | |
| **At 1 January 2013 and at 31 December 2013** | **6,196** |
| **Amortisation** | |
| At 1 January 2013 | 3,289 |
| Charge for the year | 969 |
| **At 31 December 2013** | **4,258** |
| **Net book value** | |
| **At 31 December 2013** | **1,938** |
| At 31 December 2012 | 2,907 |

## 6. Fixed asset investments

| | Investment in subsidiary undertakings £'000 | Loans £'000 | Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2013 | 51,197 | 22,000 | 73,197 |
| Additions | 8,304 | — | 8,304 |
| Disposals | (1,378) | — | (1,378) |
| **At 31 December 2013** | **58,123** | **22,000** | **80,123** |

Additions to investments in subsidiary undertakings relate to the acquisition of ILS Group Limited. The entire share capital of ILS Group Limited was acquired on 19 April 2013. Further details are provided in note 25 to the Consolidated Financial Statements.

Disposals of investments in subsidiary undertakings relate to the disposal of Haydon Mechanical & Electrical Limited. The entire share capital of Haydon Mechanical & Electrical Limited was sold on 21 November 2013. 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 15 to the Consolidated Financial Statements.

## 7. Debtors

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Amounts owed by Group undertakings | **92,375** | 74,915 |
| Prepayments and accrued income | **1,343** | 1,177 |
| Other debtors | **3,000** | — |
| Deferred tax asset | **254** | 572 |
| | **96,972** | 76,664 |

The deferred tax asset above of £0.3m is due after more than one year. The recoverability of the deferred tax asset is dependent on future taxable profits. The Company expects to realise sufficient profits to enable the deferred tax asset to be recovered.

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

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Bank loan | **25,000** | 15,000 |
| Bank overdraft | **3,673** | — |
| Other creditors | **40** | 9 |
| Accruals | **1,364** | 2,750 |
| | **30,077** | 17,759 |

Included within accruals is £1.4m (2012: £2.7m) relating to an interest rate hedge.

## 9. Creditors: amounts falling due in more than one year

| | 2013 £'000 | 2012 £'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 (2012: £0.9m) relating to deferred consideration on acquisitions.

## 10. Share capital

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| **Allotted, called up and fully paid** | | |
| At 1 January 91,859,911 (2012: 85,658,763) ordinary shares of 1p each | **919** | 857 |
| Issue of nil (2012: 2,833,489) shares on acquisition of Morrison Facilities Services Limited | **—** | 28 |
| Issue of 6,368,069 shares as a share placement | **64** | — |
| Issue of 2,433,670 (2012: 3,367,659) shares on exercise of share options | **24** | 34 |
| At 31 December 100,661,649 (2012: 91,859,91) ordinary shares of 1p each | **1,007** | 919 |

During the year, 2,433,670 (2012: 3,367,659) 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 £2.1m has been credited to the share premium account.

During the year 6,368,069 ordinary 1p shares were issued in respect of a share placement with the difference between the nominal value of £0.06m and the total consideration of £19.1m being credited to the share premium account.

During the prior 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.

# Notes to the financial statements – Company continued

## 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 2013 | 919 | 34,910 | 1,685 | (1,913) | 41,703 |
| Issue of shares | 88 | 21,172 | — | — | — |
| Share option charges | — | — | 665 | — | — |
| Exercise of share options | — | — | (1,300) | — | 1,300 |
| Cash flow hedge | — | — | — | 1,065 | — |
| Profit for the year | — | — | — | — | (1,228) |
| Equity dividends | — | — | — | — | (8,116) |
| Actuarial gain on defined benefit pension scheme net of deferred tax | — | — | — | — | (1,046) |
| **At 31 December 2013** | **1,007** | **56,082** | **1,050** | **(848)** | **32,613** |

## 12. Capital commitments

The Company had no capital commitments at 31 December 2013 or at 31 December 2012.

## 13. Contingent liabilities

The Company had no contingent liabilities at 31 December 2013 or at 31 December 2012.

## 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 2013 by a qualified independent actuary using the projected unit method.

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

| | 2013 | 2012 |
|---|---|---|
| Rate of increase of salaries – first two years term | **1.00%** | 1.00% |
| Rate of increase of salaries – long term | **3.35%** | 2.85% |
| Rate of increase for pensions in payment – based on CPI with a cap of 5% | **2.45%** | 2.20% |
| Rate of increase for pensions in payment – based on RPI with a cap of 5% | **3.25%** | 2.80% |
| Rate of increase for pensions in payment – based on CPI with a cap of 3% | **2.10%** | 1.90% |
| Rate of increase for pensions in payment – based on RPI with a cap of 3% | **2.55%** | 2.20% |
| Discount rate | **4.60%** | 4.70% |
| Expected rates of return on investments | **4.60%** | 6.85% |
| Retail Price Inflation | **3.35%** | 2.85% |
| Consumer Price Inflation | **2.45%** | 2.15% |
| Life expectancy for a 65 year old male | **22.8 years** | 22.5 years |
| Life expectancy for a 65 year old female | **25.1 years** | 24.0 years |

## 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:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Equities | 9,814 | 7,953 |
| Bonds | 2,085 | 1,835 |
| Property | — | 102 |
| Cash | 368 | 306 |
| Group's estimated asset share | 12,267 | 10,196 |
| Present value of funded scheme liabilities | (16,283) | (13,818) |
| Funded status | (4,016) | (3,622) |
| Related deferred tax asset | 843 | 833 |
| Pension liability | (3,173) | (2,789) |

The amounts recognised in the Profit and Loss Account are as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Current service cost | 207 | 195 |
| Past service cost | — | — |
| Total operating charge | 207 | 195 |
| Net interest | 148 | 29 |
| Total charged to the result for year | 355 | 224 |

Changes in the present value of the defined benefit obligations are as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Present value of obligations at 1 January | 13,818 | 13,097 |
| Current service cost | 207 | 195 |
| Past service cost | — | — |
| Interest on obligations | 647 | 636 |
| Plan participants' contributions | 63 | 76 |
| Benefits paid | (382) | (498) |
| Actuarial gain arising from changes in demographic assumptions | (1,040) | — |
| Actuarial loss arising from changes in financial assumptions | 1,453 | 312 |
| Actuarial loss arising from liability experience | 1,517 | — |
| Present value of obligations at 31 December | 16,283 | 13,818 |

# Notes to the financial statements – Company continued

## 14. Pensions continued

**Defined benefit scheme** continued

Changes in the fair value of the plan assets are as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Fair value of plan assets at 1 January | **10,196** | 8,305 |
| Expected return on plan assets | **499** | 607 |
| Employers' contributions | **1,147** | 1,192 |
| Plan participants' contributions | **63** | 76 |
| Benefits paid | **(382)** | (498) |
| Return on plan assets above that recorded in net interest | **744** | 514 |
| Fair value of plan assets at 31 December | **12,267** | 10,196 |

The movements in the net pension liability and the amount recognised in the Balance Sheet are as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| Deficit in schemes at 1 January | **(3,622)** | (4,792) |
| Current service cost | **(207)** | (195) |
| Past service cost | **—** | — |
| Contributions | **1,147** | 1,192 |
| Other finance income | **(148)** | (29) |
| Actuarial gain arising from changes in demographic assumptions | **1,040** | — |
| Actuarial loss arising from changes in financial assumptions | **(1,453)** | (312) |
| Actuarial loss arising from liability experience | **(1,517)** | — |
| Return on plan assets above that recorded in net interest | **744** | 514 |
| Deficit in schemes at 31 December | **(4,016)** | (3,622) |

Cumulative actuarial gains and losses recognised in equity are as follows:

| | 2013 £'000 | 2012 £'000 |
|---|---|---|
| At 1 January | **(5,210)** | (5,412) |
| Actuarial gain arising from changes in demographic assumptions | **1,040** | — |
| Actuarial loss arising from changes in financial assumptions | **(1,453)** | (312) |
| Actuarial loss arising from liability experience | **(1,517)** | — |
| Return on plan assets above that recorded in net interest | **744** | 514 |
| Total at 31 December | **(6,396)** | (5,210) |

## 14. Pensions continued

**Defined benefit scheme** continued

History of experience gains and losses are as follows:

| | 2013 £'000 | 2012 £'000 | 2011 £'000 | 2010 £'000 |
|---|---|---|---|---|
| Fair value of scheme assets | **12,267** | 10,196 | 8,305 | — |
| Net present value of defined benefit obligations | **(16,283)** | (13,818) | (13,097) | — |
| Net deficit | **(4,016)** | (3,622) | (4,792) | — |
| **Experience adjustments arising on scheme assets** | | | | |
| Amount | **744** | 514 | (631) | — |
| Percentage of scheme assets | **6.1%** | 5.0% | (7.6%) | — |
| **Experience adjustments arising on scheme liabilities** | | | | |
| Amount | **(1,517)** | — | — | — |
| Percentage of scheme liabilities | **(9.3%)** | — | — | — |

The employer's contributions expected to be paid during the financial year ending 31 December 2014 amount to £1.2m.

## 15. Related party transactions

The Company has taken advantage of the exemption with FRS 8 not to disclose transactions with companies which are 100% owned by the Group.

# Five year record

## Income Statement

| | 2013 £'000 | 2012 £'000 | 2011 £'000 | 2010 £'000 | 2009 £'000 |
|---|---|---|---|---|---|
| **Revenue by business segment** | | | | | |
| Social Housing | **742,479** | 504,686 | 415,000 | 379,400 | 355,260 |
| Care | **123,095** | 112,550 | 108,518 | 100,358 | 60,050 |
| Continuing activities | **865,574** | 617,236 | 523,518 | 479,758 | 415,310 |
| Discontinued activities | **32,632** | 62,289 | 65,453 | 44,177 | 54,836 |
| **Total sales revenue** | **898,206** | 679,525 | 588,971 | 523,935 | 470,146 |
| Gross profit | **227,960** | 184,305 | 174,764 | 150,533 | 133,298 |
| Operating profit before acquisition intangible amortisation and exceptional costs | **38,392** | 31,161 | 33,608 | 31,320 | 24,753 |
| Exceptional items | **(25,493)** | (2,877) | (3,094) | (2,450) | — |
| Operating profit | **2,039** | 20,323 | 22,731 | 18,751 | 19,773 |
| Profit for the year before tax | **277** | 18,199 | 20,582 | 16,352 | 18,379 |
| PBT before acquisition intangible amortisation and exceptional costs | **36,630** | 29,037 | 31,459 | 28,921 | 23,359 |
| **Earnings per share** | | | | | |
| Basic | **(1.21)p** | 19.61p | 19.87p | 17.70p | 18.81p |
| Diluted | **(1.17)p** | 18.85p | 19.03p | 16.57p | 17.94p |
| Normalised | **28.06p** | 25.60p | 26.01p | 23.38p | 21.61p |
| Dividends per share | **8.80p** | 8.00p | 7.50p | 6.75p | 5.70p |

## Balance Sheet

| | 2013 £'000 | 2012 £'000 | 2011 £'000 | 2010 £'000 | 2009 £'000 |
|---|---|---|---|---|---|
| Non-current assets | **233,960** | 225,964 | 149,923 | 146,639 | 89,824 |
| Current assets | **241,697** | 249,719 | 184,207 | 143,669 | 123,793 |
| Current liabilities | **(222,506)** | (231,934) | (169,004) | (133,119) | (98,608) |
| Non-current liabilities | **(72,850)** | (74,931) | (13,341) | (15,635) | (9,081) |
| **Total equity** | **180,301** | 168,818 | 151,785 | 141,554 | 105,928 |
| Cash and cash equivalents, end of year | **(448)** | (12,384) | (13,429) | (12,243) | 6,511 |

# Shareholder and corporate information



## Financial calendar

**Annual General Meeting**
4 June 2014

**Record date for final dividend**
13 June 2014

**Dividend warrants posted to shareholders**
3 July 2014

**Interim results announced**
19 August 2014

## Registered office

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

## Company registration number

3232863

## Company secretary

**Ben Westran**

1390 Montpellier Court
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Brockworth
Gloucester GL3 4AH
Tel: 01452 634600

## Bankers

**Barclays Bank PLC**

Wales and South West
Corporate Banking
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Counterslip
Finzels Reach
Bristol BS1 6BX
Tel: 0800 285 1152

**HSBC Bank plc**

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

## Solicitors

**BPE**

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St James' Square
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## Auditor

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Registered Auditor
Chartered Accountants
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## Financial adviser

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**Peel Hunt**

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London EC2Y 5ET
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## Registrar

**Neville Registrars Ltd**

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Halesowen
West Midlands B63 3DA
Tel: 0121 585 1131

## Investor relations

**Buchanan**

107 Cheapside
London EC2V 6DN
Tel: 020 7466 5000

## Internet

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

## Registrar

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

## Investor relations

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

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