connectgroupplc.com

**Connect Group PLC**
Rowan House
Kembrey Park
Swindon
Wiltshire
SN2 8UH
United Kingdom
0845 128 8888

# Glossary of terms

**Connect Group PLC ('the Company')**
Connect Group PLC, registered in England and Wales with registered no. 5195191.

**The Group**
Collectively, Connect Group PLC and its subsidiaries.

**Connect News & Media division**
The businesses principally operated by the following subsidiaries of Connect Group PLC:

**Smiths News**
The news businesses operated by Smiths News Trading Limited comprising Smiths News, Instore and Newsworks.

**Dawson Media Direct (or 'DMD')**
The international media business operated by a number of UK and international subsidiaries.

**Connect Books division**
The businesses principally operated by the following subsidiaries of Connect Group PLC:

**Bertrams**
The books business operated by Bertram Trading Limited.

**Dawson Books**
The books business operated by Dawson Books Limited comprising Dawson Books and the eBook platform 'Dawsonera'.

**Houtschild and Erasmus**
The international books businesses operated by Houtschild Internationale Boekhandel BV, Erasmus Antiquariaat en Boekhandel BV and Erasmus Buchhandlung GmbH.

**Connect Education & Care division**
The businesses principally operated by a subsidiary of Connect Group PLC:

**The Consortium**
The education and care business operated by The Consortium for Purchasing and Distribution Limited comprising of the business of The Consortium.

**West Mercia Supplies**
The education and care business operated by The Consortium for Purchasing and Distribution Limited comprising of the business of West Mercia Supplies.

# Shareholder information continued

**ShareGIFT**
If you only have a small number of shares which are uneconomic to sell, you may wish to consider donating them to charity under ShareGIFT, a charity share donation scheme administered by the Orr Mackintosh Foundation. A ShareGIFT transfer form may be obtained from Equiniti. Further information about the scheme can be found on the ShareGIFT website at www.sharegift.org.

**Warning to shareholders ('boiler room' scams)**
In recent years we have become aware of investors who have received unsolicited calls or correspondence, in some cases purporting to have been issued by us, concerning investment matters. These typically make claims of highly profitable opportunities in UK or US investments which turn out to be worthless or simply do not exist. These approaches are usually made by unauthorised companies and individuals and are commonly known as 'boiler room' scams. Investors are advised to be wary of any unsolicited advice or offers to buy shares. If it sounds too good to be true, it often is.

See the Financial Conduct Authority website www.fca.org.uk/consumers/scams for more detailed information about this or similar activity.

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

**UK Capital Gains Tax**
**Demerger 31 August 2006**
Following the demerger of new WH Smith PLC on 31 August 2006, in order to calculate any chargeable gains or losses arising on the disposal of shares after 31 August 2006, the original tax base cost of your old WH Smith PLC ordinary shares of $2^{13}/_{81}$p (adjusted if you held your shares at 24 September 2004 and 22 May 1998 to take into account the capital reorganisations of 27 September 2004 and 26 May 1998 respectively (see below)) will have to be apportioned between the shareholdings of ordinary shares of 5p in the Company and ordinary shares of $22^{6}/_{67}$p (or 20p if the disposal took place before 22 February 2008) in new WH Smith PLC in the ratio of 0.30415 and 0.69585 respectively.

**Capital reorganisation 27 September 2004**
If your shares result from a holding of old WH Smith PLC shares acquired on or before 24 September 2004, in order to calculate any chargeable gains or losses arising on the disposal of shares after 24 September 2004, the original tax base cost of your old WH Smith PLC ordinary shares of $55^{5}/_{9}$p (adjusted if you held your shares as at 22 May 1998 to take into account the capital reorganisation of 26 May 1998 (see below)) will have to be apportioned between the shareholdings of ordinary shares of $2^{13}/_{81}$p and 'C' shares resulting from the capital reorganisation.

The cost of your shareholding of ordinary shares of $2^{13}/_{81}$p is calculated by multiplying the original base cost of your ordinary shares of $55^{5}/_{9}$p (adjusted where necessary to take into account the capital reorganisation of 26 May 1998 referred to above) by 0.73979.

**Capital reorganisation 26 May 1998**
If your shares result from a holding of old WH Smith PLC shares acquired on or before 22 May 1998, in order to calculate any chargeable gains or losses arising on the disposal of shares after 22 May 1998, the original tax base cost of your old WH Smith PLC ordinary shares of 50p will have to be apportioned between the shareholdings of ordinary shares of $55^{5}/_{9}$p and redeemable 'B' shares resulting from the capital reorganisation.

The cost of your shareholding of ordinary shares of $55^{5}/_{9}$p is calculated by multiplying the original cost of your ordinary shares of 50p by 0.90714.

**March 1982 values**
If your shares result from a holding of old WH Smith PLC shares acquired on or before 31 March 1982, the tax base cost to be used in order to calculate any chargeable gains or losses arising on the disposal of shares is the 31 March 1982 base values per share as follows:

| | Arising from an original shareholding of old WH Smith PLC | |
|---|---|---|
| | 'A' ordinary shares | 'B' ordinary shares |
| Ordinary shares of 5p | 26.93p | 22.25p |
| WH Smith PLC ordinary shares of $22^{6}/_{67}$p | 61.62p | 50.92p |

If you have a complicated tax position, or are otherwise in doubt about your tax circumstances, or if you are subject to tax in a jurisdiction other than the United Kingdom, you should consult your professional adviser.

# Shareholder information

**Company Secretary and registered office**
Stuart Marriner, Connect Group PLC, Rowan House, Cherry Orchard North, Kembrey Park, Swindon, Wiltshire SN2 8UH.

Telephone 0845 128 8888.

Connect Group PLC is registered in England and Wales (Number 5195191).

**Company website**
Connect Group PLC Annual Reports and results announcements are available via the internet on our website www.connectgroupplc.com. The site provides a wide range of information for investors about the Company including annual reports, regulatory news releases, share price data, financial calendar and a Shareholder Centre containing AGM and other useful shareholder information.

**Annual Report and Accounts**
This Annual Report and Accounts is published on our website at www.connectgroupplc.com and has only been sent to those shareholders who have asked for a copy. Shareholders who have not requested a paper copy of the Annual Report and Accounts have been notified of its availability on the website.

A paper copy of the Annual Report and Accounts can be obtained by writing to the Company Secretary, Connect Group PLC, Rowan House, Cherry Orchard North, Kembrey Park, Swindon, Wiltshire SN2 8UH or you can e-mail your request to investor.relations@connectgroupplc.com.

**Annual General Meeting**
The AGM will be held at Rowan House, Cherry Orchard North, Kembrey Park, Swindon, Wiltshire SN2 8UH on Wednesday 4 February 2015 at 11.30am. The Notice of AGM sets out the business to be transacted. Shareholders who wish to attend the meeting should detach the Attendance Card from the Proxy Form and present it at the registration desk on arrival.

**Proxy Form**
Shareholders unable to attend the AGM should complete a Proxy Form. To be effective, it must be completed and lodged with the Company's Registrars, Equiniti, by not later than 11.30am on Monday 2 February 2015.

**Electronic proxy voting**
You may if you wish register the appointment of a proxy for the meeting electronically, by logging onto the website www.sharevote.co.uk. Full details of the procedure are given on the website. You will need to have your Proxy Form to hand when you log on as it contains information which will be required. CREST members may appoint a proxy electronically via Equiniti (ID RA19). Electronic proxy voting instructions must be received by not later than 11.30am on Monday 2 February 2015.

**Registrars**
If you have any enquiries about your shareholding in Connect Group PLC or wish to advise of a change of address, please contact Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA (telephone 0871 384 2771[1] or from outside the UK +44 (0) 121 415 7565). A textphone facility for shareholders with hearing difficulties is available by telephoning 0871 384 2255[1]. In addition, Equiniti provides a range of shareholder information online at www.shareview.co.uk (to register for this service you will need your shareholder reference number which can be found on the Proxy Form).

1 Calls to this number cost 8p per minute plus network extras. Lines are open from 8.30am to 5.30pm, Monday to Friday, excluding UK bank holidays.

**Financial calendar**

| | |
|---|---|
| Financial year end | 31 August 2014 |
| Results announced | 15 October 2014 |
| Annual Report published | 1 December 2014 |
| Final dividend ex-dividend date | 8 January 2015 |
| Final dividend record date | 9 January 2015 |
| Annual General Meeting | 4 February 2015 |
| Final dividend payment date | 6 February 2015 |
| Half-year end | 28 February 2015 |
| Interim results announced | April 2015 |
| Interim dividend ex-dividend date | June 2015 |
| Interim dividend record date | June 2015 |
| Interim dividend payment date | July 2015 |
| Financial year end | 31 August 2015 |
| Results announced | October 2015 |

For the dates of events in the second half of the financial calendar, please check the Connect Group PLC website at www.connectgroupplc.com nearer the relevant time for further details, and to ensure that no changes have been made.

The dividend dates shown above are in respect of the Company's ordinary shares of 5p.

**Share dealing service**
The Company has arranged for Shareview Dealing, a telephone and internet share dealing service offered by Equiniti, to be made available to UK shareholders wishing to buy or sell the Company's shares. For telephone dealing call 08456 037 037 between 8.30am and 4.30pm, Monday to Friday, and for internet dealing log on to www.shareview.co.uk/dealing. You will need your shareholder reference number shown on your share certificate.

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the Company balance sheet continued

**5. Called up share capital** continued
**(b) Movement in share capital**

| Number (m) | Ordinary shares of 5p each |
|---|---|
| At 1 September 2013 | 184.3 |
| Issued in the year | 5.0 |
| At 31 August 2014 | 189.3 |

The holders of ordinary shares are entitled to receive dividends as declared from time-to-time and are entitled to one vote per share at the meetings of the Company. The Company has one class of ordinary shares, which carry no right to fixed income.

**(c) Share Premium**

| £m | **2014** | 2013 |
|---|---|---|
| Balance at 1 September | **1.2** | 0.6 |
| Share issues during the year | **4.1** | 0.6 |
| **Balance at 31 August** | **5.3** | 1.2 |

**6. Reserves**

| £m | Retained earnings |
|---|---|
| Balance at 1 September 2013 | 73.0 |
| Dividend paid | (17.7) |
| Dividend received | – |
| **Balance at 31 August 2014** | **55.3** |

The Company received no dividends during the year. In 2013 the Company received a dividend from wholly owned subsidiary, Smiths News Holdings Limited of £60m.

**7. Related party transactions**
The Company has taken advantage of the exemption granted by paragraph 3(c) of FRS 8, Related Party Disclosures, not to disclose transactions with Connect Group PLC companies and interests of the Group, which are related parties.

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the Company balance sheet

**1. Accounting policies**

**(a) Accounting convention**

The accounts are prepared in compliance with the Companies Act 2006 and in accordance with applicable United Kingdom law and accounting standards. The accounts are prepared under the historical cost convention. The accounting policies have been applied consistently in the current and prior year. In accordance with FRS 1 (Revised), a statement of cash flows has not been prepared.

**(b) Investment in subsidiary undertakings**

Investments in subsidiary undertakings are individually valued at historical cost less provision for impairment in value.

**(c) Financial liabilities and equities**

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

**(d) Taxation**

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

**2. Result for the year**

The Company has not presented its own profit and loss account as permitted by section 408 of the Companies Act 2006. The result for the year attributable to shareholders, which is stated on an historical cost basis, was £nil. In 2013 the result for the year was £60m, being investment revenue received from a wholly owned subsidiary Smiths News Holdings Limited. There were no other recognised gains or losses. Dividend paid in the year is £17.7m (2013: £16.0m).

**3. Investments in subsidiary undertakings**

| £m | **2014** | 2013 |
|---|---|---|
| **Net book value:** | | |
| At 1 September | **520.0** | 520.0 |
| **At 31 August** | **520.0** | 520.0 |

An impairment of £142.9m has been recognised historically against the cost of these investments.

**4. Creditors: amounts falling due after more than one year**

| £m | **2014** | 2013 |
|---|---|---|
| Amounts owed to Group companies | **449.9** | 436.6 |

The amounts owed to Group companies are not considered to be repayable within five years. These balances are not interest bearing.

**5. Called up share capital**

| £m | **2014** | 2013 |
|---|---|---|
| **Authorised:** | | |
| 300.0m ordinary shares of 5p each | **15.0** | 15.0 |

| £m | **2014** | 2013 |
|---|---|---|
| **Issued and fully paid ordinary shares of 5p each** | | |
| At 1 September | **9.2** | 9.2 |
| Shares issued in the year | **0.3** | – |
| At 31 August | **9.5** | 9.2 |

During the year 4,959,905 (2013: 763,101) ordinary 5p shares were issued for a consideration of £4,373,469 (2013: £655,352), resulting in a share premium of £4,125,474 (2013: £617,197). Of these 4,530,012 relate to the deferred share capital payable to the former owners of Hedgelane Limited following its acquisition in April 2012, the remainder were issued to satisfy share scheme exercises.

# Connect Group PLC (formerly Smiths News PLC) Reconciliation of movements in shareholders' funds

For the year ended 31 August 2014

| £m | **2014** | 2013 |
|---|---|---|
| Opening shareholders' funds | **83.4** | 38.8 |
| Dividend paid | **(17.7)** | (16.0) |
| Shares issued in the year | **4.4** | 0.6 |
| Dividend received | **–** | 60.0 |
| **Net increase in shareholders' funds** | **(13.3)** | **44.6** |
| **Closing shareholders' funds** | **70.1** | **83.4** |

# Connect Group PLC (formerly Smiths News PLC) Company balance sheet

## As at 31 August 2014

| £m | Note | 2014 | 2013 |
|---|---|---|---|
| **Fixed Assets** | | | |
| Investments in subsidiary undertakings | 3 | **520.0** | 520.0 |
| | | **520.0** | **520.0** |
| **Creditors: amounts falling due after more than one year** | 4 | **(449.9)** | (436.6) |
| **Total net assets** | | **70.1** | **83.4** |
| **Capital and Reserves** | | | |
| Called up share capital | 5 | **9.5** | 9.2 |
| Share premium account | 5(c) | **5.3** | 1.2 |
| Retained earnings | 6 | **55.3** | 73.0 |
| **Total shareholders' funds** | | **70.1** | **83.4** |

These accounts were approved by the Directors on 15 October 2014.

Registered number – 05195191

Signed on behalf of the Board of Directors

**Mark Cashmore**
**Director**

**Nick Gresham**
**Director**

# Connect Group PLC (formerly Smiths News PLC)
# Five-year financial summary (unaudited)
# Group income statement

| £m | 12 months to<br>31 August 2014 | 31 August[1] 2013 | 31 August 2012 | 31 August 2011 | 31 August 2010 |
|---|---|---|---|---|---|
| Revenue | **1,808.5** | 1,810.8 | 1,803.9 | 1,734.4 | 1,829.6 |
| **Operating profit before non-recurring items** | **55.5** | 56.4 | 51.2 | 41.7 | 37.1 |
| Non-recurring items | **(6.9)** | (10.8) | (10.9) | (6.5) | (6.9) |
| **Operating profit** | **48.6** | 45.6 | 40.3 | 35.2 | 30.2 |
| Net finance charges | **(5.5)** | (6.5) | (3.7) | (3.1) | (2.1) |
| Non-recurring interest cost | – | (0.2) | – | – | – |
| **Profit before tax** | **43.1** | 38.9 | 36.6 | 32.1 | 28.1 |
| Income tax expense | **(8.3)** | (10.2) | (9.1) | (10.2) | (6.9) |
| **Profit for the period** | **34.8** | 28.7 | 27.5 | 21.9 | 21.2 |
| | | | | | |
| **Statutory earnings per share** | | | | | |
| Basic | **18.6p** | 15.7p | 15.2p | 12.1p | 11.7p |
| Diluted | **18.0p** | 14.8p | 14.7p | 11.9p | 11.5p |
| **Underlying earnings per share** | | | | | |
| Basic – continuing operations | **21.7p** | 21.1p | 19.9p | 15.5p | 14.6p |
| Diluted | **21.0p** | 19.8p | 19.3p | 15.3p | 14.4p |
| Dividend per share | **9.7p** | 9.3p | 8.6p | 8.0p | 7.4p |
| Dividend paid (£m) | **17.7** | 16.0 | 14.9 | 13.8 | 12.6 |
| | | | | | |
| **Leverage** | | | | | |
| Free cash flow | **37.2** | 32.6 | 27.2 | 22.5 | 20.4 |
| Operating cash flow | **47.4** | 37.9 | 28.5 | 25.2 | 24.7 |
| Total net debt | **(93.0)** | (98.5) | (100.5) | (63.3) | (48.0) |
| Net debt/EBITDA (covenant 2.75x) | **1.4** | 1.5 | 1.6 | 1.3 | 1.1 |
| Interest cover (covenant 3x) | **11.8** | 13.9 | 12.9 | 14.2 | 17.3 |
| Fixed charge cover (covenant 2.0x) | **4.7** | 5.3 | 4.9 | 3.6 | 4.5 |

1 Restatement in respect of retirement benefit obligations, see Note 34.

# Connect Group PLC (formerly Smiths News PLC)
# Five-year financial summary (unaudited)
# Group balance sheet

| £m | 31 August 2014 | 31 August 2013 | 31 August 2012 | 31 August 2011 | 31 August 2010 |
|---|---|---|---|---|---|
| Non-current assets | **107.1** | 107.6 | 106.1 | 71.7 | 39.0 |
| Current assets | **193.8** | 181.4 | 170.0 | 149.4 | 142.2 |
| Current liabilities | **(267.7)** | (283.0) | (272.2) | (226.6) | (237.6) |
| Non-current liabilities | **(73.4)** | (60.1) | (76.8) | (77.0) | (4.1) |
| Long-term provisions | **(1.9)** | (2.8) | (4.7) | (4.9) | (1.9) |
| **Net liabilities** | **(42.1)** | (56.9) | (77.6) | (87.4) | (62.4) |
| Equity | **14.8** | 10.4 | 9.8 | 9.7 | 9.6 |
| Retained earnings | **228.5** | 214.9 | 196.7 | 187.7 | 211.0 |
| Other reserves | **(285.6)** | (282.2) | (284.1) | (284.8) | (283.0) |
| Non-controlling interests in equity | **0.2** | – | – | – | – |
| | **(42.1)** | (56.9) | (77.6) | (87.4) | (62.4) |

**34. Restatement following the adoption of IAS19 revised and disposal of MMC**

IAS19 (as revised in June 2011) 'Employee Benefits' has been adopted by the Group for the financial year commencing 1 September 2013. The interest cost and expected return on defined-benefit pension scheme assets used in the previous version of IAS19 are replaced with a 'net interest' amount, which is calculated by applying a discount rate to the net defined benefit liability or asset. Furthermore, IAS19 (revised) also introduces more extensive disclosures in the presentation of the defined benefit cost, including the separate disclosure of the schemes' administrative expenses.

The comparative period has also been restated to show the results of the MMC business, disposed of in April 2013, within non-recurring and other items, reducing underlying revenue by £3.9m and underlying operating profit by £0.1m for the year ended 31 August 2013.

The adoption of IAS19 (revised) and the MMC restatement has had no impact on the balance sheet position of the Group as at 31 August 2013 and 31 August 2012 and no impact on the cash flows of the Group.

The impact on the comparative Group Income Statement and Statement of Changes in Equity is set out below:

| Group Income Statement | 12 months to 31 August 2013 | | |
|---|---|---|---|
| £m | Reported | Adjustment | Restated |
| **Disposal of MMC** | | | |
| Underlying revenue | 1,810.8 | (3.9) | 1,806.9 |
| Operating profit – underlying | 56.5 | (0.1) | 56.4 |
| **IAS19 (Revised)** | | | |
| Investment revenues | 1.8 | (1.5) | 0.3 |
| Finance costs | (5.3) | (1.5) | (6.8) |
| Profit before tax – underlying | 53.0 | (3.0) | 50.0 |
| Taxation | (12.1) | 0.6 | (11.5) |
| Profit for the period – underlying | 40.9 | (2.4) | 38.5 |
| **Combined restatement** | | | |
| **Revenue** | 1,810.8 | (3.9) | 1,806.9 |
| **Operating profit – underlying** | 56.5 | (0.1) | 56.4 |
| **Profit before tax – underlying** | 53.0 | (3.1) | 49.9 |
| Non-recurring and other items | (11.1) | 0.1 | (11.0) |
| **Profit before tax – statutory** | 41.9 | (3.0) | 38.9 |
| Taxation – including non-recurring | (10.8) | 0.6 | (10.2) |
| **Profit for the period – statutory** | 31.1 | (2.4) | 28.7 |
| Underlying EPS – basic | 22.4p | (1.3p) | 21.1p |
| Underlying EPS – diluted | 21.1p | (1.3p) | 19.8p |
| Statutory EPS – basic | 17.1p | (1.4p) | 15.7p |
| Statutory EPS – diluted | 16.0p | (1.2p) | 14.8p |

| Group Statement of Changes in Equity | 12 months to 31 August 2013 | | |
|---|---|---|---|
| £m | Previously reported | Impact of adopting IAS19 (revised) | Restated |
| Impact of IFRIC 14 on defined benefit schemes | 0.3 | 3.1 | 3.4 |
| Actuarial gain | 4.5 | (0.2) | 4.3 |
| Gain on cash flow hedges | 1.7 | – | 1.7 |
| Tax relating to components of other comprehensive income | (1.9) | (0.6) | (2.5) |
| **Other comprehensive income** | **4.6** | **2.3** | **6.9** |
| Profit after tax | 31.1 | (2.4) | 28.7 |
| **Total comprehensive income** | **35.7** | **(0.1)** | **35.6** |

# Connect Group PLC (formerly Smiths News PLC)
## Notes to the accounts continued

**32. Related party transactions** continued
**Aggregate remuneration of key management personnel**

The remuneration of the Directors and the executive management team, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS24 *'Related Party Disclosures'.*

| £m | **2014** | 2013 |
|---|---|---|
| Short-term employee benefits | **3.0** | 3.0 |
| Post-employment benefits | **–** | – |
| Share-based payments | **0.8** | 1.1 |
| | **3.8** | 4.1 |

Information concerning directors' remuneration, interest in shares and share options are included in the Remuneration Report on pages 41 to 57.

**Directors' transactions**
There are no other transactions with Directors, other than those set out in Note 6.

**33. Principal subsidiary undertakings and associated undertakings**

| Name | Country of incorporation/registration | Proportion of ownership interest |
|---|---|---|
| Bertram Trading Limited | England | 100% |
| Bluebox Avionics Limited* | England | 50% |
| The Consortium for Purchasing and Distribution Ltd | England | 100% |
| Dawson Books Limited | England | 100% |
| Dawson Espana Agencia De Ediciones SL | Spain | 100% |
| Dawson France SAS | France | 100% |
| Dawson Holdings Limited | England | 100% |
| Dawson Media Direct China Limited | Hong Kong | 100% |
| Dawson Media Direct GmbH | Germany | 100% |
| Dawson Media Direct Inc. | USA | 100% |
| Dawson Media Direct Limited | England | 100% |
| Dawson Media Direct NV | Belgium | 99% |
| Dawson Media Direct SAS | France | 100% |
| Erasmus Antiquariaat en Boekhandel B.V. | Netherlands | 100% |
| FMD Limited* | England | 50% |
| Hedgelane Limited | England | 100% |
| Houtschild Internationale Boekhandel B.V. | Netherlands | 100% |
| Magpie Investments Limited[1] | England | 51% |
| Martin Lavell Ltd | England | 100% |
| Phantom Media Limited | England | 100% |
| Rascal Solutions Limited* | England | 50% |
| Smiths News Holdings Limited | England | 100% |
| Smiths News Trading Limited | England | 100% |

Except as marked all of the above are subsidiaries of Connect Group PLC. Those marked with an asterisk are joint controlled entities, for details of which see Note 15 to the Group accounts.

A full list of subsidiary companies is available from the Company's registered office.

1 Magpie Investments Limited is treated as a subsidiary within the Group financial statements based upon the Group's majority shareholding and the controlling interest on the Board.

**31. Share-based payments** continued

Details of the options/awards granted or commencing during the current and comparative year are as follows:

| | Sharesave | ESOS | LTIP | DBP |
|---|---|---|---|---|
| **During 2014:** | | | | |
| Effective date of grant or commencement date | June 2014 | Nov 2013 | Nov 2013 | Nov 2013 |
| Average fair value at date of grant or scheme commencement – pence | 42.5 | 28.6 | 188.2 | 188.2 |
| During 2013: | | | | |
| Effective date of grant or commencement date | June 2013 | Nov 2012 | Nov 2012 | Nov 2012 |
| Average fair value at date of grant or scheme commencement – pence | 38.6 | 19.5 | 156.6 | 156.6 |

The options outstanding at 31 August 2014 had exercise prices ranging from nil to 210.3p (2013: nil to 152.9p).

The weighted average share price on the date of exercise was 200p (2013: 161p).

The sharesave and ESOS options granted during each period have been valued using the Black-Scholes model, the LTIP and DBP schemes are valued by reference to the share price at the date of grant discounted by the estimated dividend yield per cent.

The inputs to the Black-Scholes model are as follows:

| | Sharesave | ESOS | LTIP | DBP |
|---|---|---|---|---|
| **2014 options/awards:** | | | | |
| Share price at grant date – pence | 197.5 | 210.3 | 210.3 | 210.3 |
| Exercise price – pence | 158.0 | 210.3 | – | – |
| Expected volatility – per cent | 32.0 | 31.0 | – | – |
| Expected life – years | 3.0 | 3.0 | – | – |
| Risk free rate – per cent | 1.96 | 1.61 | – | – |
| Expected dividend yield – per cent | 6.2 | 6.2 | – | – |
| Weighted average fair value – pence | 42.5 | 28.6 | 185.0 | 185.0 |
| 2013 options/awards: | | | | |
| Share price at grant date – pence | 175.0 | 152.9 | 152.9 | 152.9 |
| Exercise price – pence | 140.0 | 152.9 | – | – |
| Expected volatility – per cent | 33.0 | 29.0 | – | – |
| Expected life – years | 3.0 | 3.0 | – | – |
| Risk free rate – per cent | 1.25 | 1.25 | – | – |
| Expected dividend yield – per cent | 5.5 | 5.5 | 5.5 | 5.5 |
| Weighted average fair value – pence | 38.6 | 19.5 | 136.7 | 136.7 |

**32. Related party transactions**

Transactions between businesses within this Group, which are related parties, have been eliminated on consolidation and are not disclosed in this Note.

Transactions with the Group's pension schemes are disclosed in Note 6.

**Trading transactions**

| | Sales to related parties | | Amounts owed by related parties | |
|---|---|---|---|---|
| £m | **2014** | 2013 | **2014** | 2013 |
| Jointly controlled entities | **3.2** | 0.1 | **0.6** | 0.3 |

Sales to related parties are for management fees, payment is due on the last day of the month following the date of invoice.

**Non-trading transactions**

| | Loans to related parties | |
|---|---|---|
| £m | **2014** | 2013 |
| Jointly controlled entities | **0.4** | 0.6 |

The loans to related parties have no set date for repayment and accrue interest at LIBOR + 2%.

# Connect Group PLC (formerly Smiths News PLC)
## Notes to the accounts continued

### 31. Share-based payments
The Group recognised total expenses of £1.5m in 2014 (2013: £1.9m) related to equity-settled share-based payment transactions.

Average share price throughout the year was 191.5p (2013: 158.8p).

The Group operates the following share incentive schemes:

**Sharesave Scheme**
Under the terms of the Smiths News Sharesave Scheme, the Board may grant options to purchase ordinary shares in the Company to eligible employees who enter into an HM Revenue & Customs approved Save-As-You-Earn (SAYE) savings contract for a term of three or five years. Options are granted at a 20% discount to the market price of the shares on the day preceding the date of offer and are normally exercisable for a period of six months after completion of the SAYE contract.

**Executive Share Option Schemes ('ESOS')**
Under the terms of the Smiths News Executive Share Option Scheme, the Board may grant options to purchase ordinary shares in the Company to executives up to an annual limit of 200% of base salary. The exercise of options is conditional on the achievement of a three year performance target, which is determined by the Remuneration Committee at the time of grant. Provided that the target is met, options are normally exercisable until the day preceding the tenth anniversary of the date of grant.

**LTIP**
Under the terms of the Connect Group LTIP, executive directors and key senior executives may be awarded each year conditional entitlements to ordinary shares in the Company (in the form of nil cost options) or, in order to retain flexibility and at the Company's discretion, a cash sum linked to the value of a notional award of shares up to a value of 200% of base salary. The vesting of awards is subject to the satisfaction of a three year performance condition, which is determined by the Remuneration Committee at the time of grant. Subject to the satisfaction of the performance condition, awards are normally exercisable until the tenth anniversary of the date of grant.

**Deferred Bonus Plan ('DBP')**
Under the terms of the Connect Group Deferred Bonus Plan, executive directors and key senior executives may be granted each year share awards (in the form of nil cost options) dependent on the achievement of the Annual Bonus Plan and Economic Profit Plan performance targets. Awards are normally exercisable after two years subject to continued employment.

Details of the options/awards are as follows:

| | Sharesave | | ESOS | | LTIP | | DBP | |
|---|---|---|---|---|---|---|---|---|
| Number of options/awards | No of shares | Weighted average exercise price | No of shares | Weighted average exercise price | No of shares | Weighted average exercise price | No of shares | Weighted average exercise price |
| At 31 Aug 2012 | 2,853,975 | 83.4p | 6,612,582 | 91.5p | 2,310,894 | – | 1,117,654 | – |
| Granted | 665,877 | 140.0p | 1,032,399 | 152.9p | 715,988 | – | 517,767 | – |
| Exercised | (763,101) | 85.9p | (2,821,302) | 89.0p | (454,506) | – | (638,319) | – |
| Expired/Forfeited | (301,193) | 82.8p | (235,511) | 97.1p | (27,896) | – | – | – |
| At 31 Aug 2013 | 2,455,558 | 98.0p | 4,588,168 | 106.5p | 2,544,480 | – | 997,102 | – |
| Granted | 850,683 | 158.0p | 895,607 | 210.3p | 601,195 | – | 450,021 | – |
| Exercised | (429,893) | 86.9p | (503,897) | 92.8p | (969,253) | – | (486,519) | – |
| Expired/Forfeited | (249,010) | 101.4p | (255,367) | 134.2p | (125,231) | – | (19,219) | – |
| **At 31 Aug 2014** | **2,627,338** | **118.9p** | **4,724,511** | **126.1p** | **2,051,191** | – | **941,385** | – |
| | | | | | | | | |
| **Exercisable at 31 Aug 2014** | **232,584** | **80.7p** | **1,652,486** | **92.7p** | – | – | – | – |
| Exercisable at 31 Aug 2013 | 213,815 | 93.2p | 604,592 | 94.3p | – | – | – | – |

The weighted average remaining contractual life in years of options/awards is as follows:

| | Sharesave | ESOS | LTIP | DBP |
|---|---|---|---|---|
| **Outstanding at 31 August 2014** | **1.5** | **7.5** | **8.1** | **1.7** |
| Outstanding at 31 August 2013 | 1.8 | 7.6 | 8.4 | 0.6 |

## 29. Reserves

### (a) Demerger reserve

| £m | **2014** | 2013 |
|---|---|---|
| At 1 September | **(280.1)** | (280.1) |
| At 31 August | **(280.1)** | (280.1) |

This relates to reserves created following the capital reorganisation undertaken as part of the demerger of WH Smith PLC in 2006. The balance represented the difference between the share capital and reserves of the Group restated on a pro-forma basis as at 31 August 2004 and the previously reported share capital.

### (b) ESOP reserve

| £m | **2014** | 2013 |
|---|---|---|
| Balance at 1 September | **(1.5)** | (1.7) |
| Acquired in the period | **(6.3)** | (3.0) |
| Disposed of on exercise of options | **2.6** | 3.2 |
| Balance at 31 August | **(5.2)** | (1.5) |

The ESOP reserve represents the cost of shares in Connect Group PLC purchased in the market and held by the Smiths News Employee Benefit Trust to satisfy awards and options granted under the Group's Executive Share Schemes (see Note 31). The number of ordinary shares held by the Trust at 31 August 2014 was 2,203,191 (2013: 1,070,854).

### (c) Hedging and translation reserve

| £m | **2014** | 2013 |
|---|---|---|
| Balance at 1 September | **(0.6)** | (2.3) |
| Gain recognised on cash flow hedges (net of tax) | **0.5** | 1.7 |
| Exchange differences on translating net assets of foreign operations | **(0.2)** | – |
| Balance at 31 August | **(0.3)** | (0.6) |

The hedging reserve represents the cumulative amount of gains and losses on hedging instruments deemed effective in cash flow hedges. The cumulative deferred gain or loss on the hedging instrument is recognised in the profit or loss only when the hedged transaction impacts the profit or loss.

## 30. Retained earnings

| | £m |
|---|---|
| Balance at 1 September 2012 | 196.7 |
| Total comprehensive income for the year | 33.9 |
| Dividends paid | (16.0) |
| Employee share schemes | (0.2) |
| Credit for equity-settled share-based payments | 0.5 |
| **Balance at 31 August 2013** | 214.9 |
| Total comprehensive income for the year | 33.3 |
| Dividends paid | (17.7) |
| Employee share schemes | (2.6) |
| Equity-settled share-based payments, net of tax | 0.6 |
| Balance at 31 August 2014 | **228.5** |

# Connect Group PLC (formerly Smiths News PLC)
## Notes to the accounts continued

### 27. Net cash inflow from operating activities

| £m | 2014 | 2013 |
|---|---|---|
| Operating profit | **48.6** | 45.6 |
| Acquisition costs | **–** | 3.2 |
| Share of profits of jointly controlled entities | **(0.3)** | – |
| Adjustment for pension funding | **(4.6)** | (6.5) |
| Depreciation of property, plant and equipment | **5.2** | 5.3 |
| Amortisation and impairment of intangible assets | **6.3** | 5.0 |
| Share-based payments | **1.1** | 1.9 |
| (Increase)/decrease in inventories | **(1.7)** | 0.4 |
| Increase in receivables | **(2.4)** | (5.8) |
| Decrease in payables | **7.3** | 1.5 |
| Income tax paid | **(9.8)** | (10.5) |
| Decrease in provisions | **(2.3)** | (2.2) |
| **Net cash inflow from operating activities** | **47.4** | 37.9 |

### 28. Share capital
#### (a) Share capital

| £m | 2014 | 2013 |
|---|---|---|
| **Authorised:** | | |
| 300.0m ordinary shares of 5p each | **15.0** | 15.0 |
| **Issued and fully paid:** | | |
| 189.3m ordinary shares of 5p each (2013: 184.3m) | **9.5** | 9.2 |

#### (b) Movement in share capital

| £m | Ordinary shares of 5p each |
|---|---|
| 31 August 2013 | 9.2 |
| Shares issued during the year | 0.3 |
| **At 31 August 2014** | **9.5** |

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at the general meetings of the Company. The Company has one class of ordinary shares, which carry no right to fixed income.

During the year 4,959,905 (2013: 763,101) ordinary 5p shares were issued for a consideration of £4,373,469 (2013: £655,352), resulting in a share premium of £4,125,474 (2013: £617,197). Of these 4,530,012 relate to the deferred share capital payable to the former owners of Hedgelane Limited following its acquisition in April 2012, the remainder were issued to satisfy share scheme exercises.

The concept of authorised share capital was repealed by the Companies Act 2006 with effect from 1 October 2009, and on 15 January 2010, the Company passed a Special Resolution disapplying the existing provisions of its Memorandum of Association from applying to its Articles of Association.

#### (c) Share premium

| £m | 2014 | 2013 |
|---|---|---|
| Balance at 1 September | **1.2** | 0.6 |
| Premium arising on issue of equity shares | **4.1** | 0.6 |
| Balance at 31 August | **5.3** | 1.2 |

**24. Provisions** continued

| £m | **2014** | 2013 |
|---|---|---|
| Included within current liabilities | **3.4** | 7.5 |
| Included within non-current liabilities | **1.9** | 2.8 |
| **Total** | **5.3** | 10.3 |

Reorganisation provisions include amounts for programmes, primarily redundancy costs, that have been announced prior to the year end and are all expected to be utilised during the following financial year.

Insurance provisions represent the expected future costs of employer's liability, public liability and motor accident claims.

The property provision represents the estimated future cost of the Group's onerous and reversionary leases in non-trading properties based on known and estimated rental sub-leases. This provision has been discounted at a risk free rate and this discount will be unwound over the life of the leases. The provision is expected to be utilised over the period to 2019, when all of the leases provisions will have expired.

Deferred consideration relates to amounts provided in relation to the acquisition of Hedgelane Ltd on 23 April 2012, the cost was contingent upon future employment. The provision has been fully utilised in the year with the issue of 4,530,012 shares in January 2014.

**25. Contingent liabilities and capital commitments**

| £m | **2014** | 2013 |
|---|---|---|
| Bank and other loans guaranteed | **2.1** | 3.6 |

Other potential liabilities that could crystallise are in respect of previous assignments of leases where the liability could revert to the Group if the lessee defaulted. Pursuant to the terms of the Demerger Agreement, any such contingent liability in respect of assignment prior to demerger, which becomes an actual liability, will be apportioned between Connect Group PLC and WH Smith PLC in the ratio 35:65 (provided that the actual liability of Connect Group PLC in any 12 month period does not exceed £5m). The Company's share of these leases has an estimated future cumulative gross rental commitment at 31 August 2014 of £6.3m (2013: £8.4m). This excludes the reversionary lease provision included within property provisions in Note 24.

Contracts placed for future capital expenditure approved by the directors but not provided for amount to: £nil (2013: £nil).

**26. Operating lease commitments**
**The Group as lessee:**
Minimum lease payments under non-cancellable operating leases are as follows:

| | **2014** | | | 2013 | | |
|---|---|---|---|---|---|---|
| £m | **Land and buildings** | **Equipment and vehicles** | **Total** | Land and buildings | Equipment and vehicles | Total |
| Within one year | **7.7** | **2.1** | **9.8** | 8.1 | 1.6 | 9.7 |
| In the second to fifth years inclusive | **25.6** | **1.5** | **27.1** | 26.2 | 1.6 | 27.8 |
| In more than five years | **24.3** | **–** | **24.3** | 26.7 | – | 26.7 |
| | **57.6** | **3.6** | **61.2** | 61.0 | 3.2 | 64.2 |

The Group leases various distribution properties and plant and equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

**The Group as lessor:**
At the balance sheet date, the Group had contracted with tenants for the following future minimum lease payments:

| £m | **2014** | 2013 |
|---|---|---|
| Within one year | **0.1** | – |
| In the second to fifth years inclusive | **0.2** | 0.3 |
| | **0.3** | 0.3 |

Property rental income earned during the year was £0.1m (2013: £0.4m).

**23. Deferred tax**

Deferred tax assets and liabilities are attributable to the following:

| £m | Accelerated tax depreciation | Other | Share-based payments | Intangible assets | Retirement benefits | Total |
|---|---|---|---|---|---|---|
| At 1 September 2013 | 0.1 | 0.6 | 1.5 | (3.5) | 4.9 | 3.6 |
| Charge to income | 0.5 | (0.4) | 0.2 | 0.4 | (0.1) | 0.6 |
| Charge to other comprehensive income | – | (0.1) | 0.5 | – | (0.6) | (0.2) |
| **At 31 August 2014** | **0.6** | **0.1** | **2.2** | **(3.1)** | **4.2** | **4.0** |
| Deferred tax assets | 0.7 | 0.1 | 2.2 | – | 4.2 | 7.2 |
| Deferred tax liabilities | (0.1) | – | – | (3.1) | – | (3.2) |
| At 1 September 2012 | (0.2) | 1.1 | 0.9 | (4.1) | 8.2 | 5.9 |
| Charge to income | 0.4 | (0.2) | 0.1 | 0.6 | – | 0.9 |
| Charge to other comprehensive income | – | (0.3) | 0.5 | – | (3.3) | (3.1) |
| Acquisition/disposal of subsidiary | (0.1) | – | – | – | – | (0.1) |
| **At 31 August 2013** | 0.1 | 0.6 | 1.5 | (3.5) | 4.9 | 3.6 |
| Deferred tax assets | 0.4 | 1.3 | 1.5 | – | 4.9 | 8.1 |
| Deferred tax liabilities | (0.3) | (0.7) | – | (3.5) | – | (4.5) |

The Company has capital losses carried forward of £23.9m (2013: £23.9m). Deferred tax assets have not been recognised in respect of the capital losses carried forward due to the uncertainty of their utilisation.

The Finance Act 2013, which provides for a reduction in the main rate of corporation tax from 21% to 20%, effective from 1 April 2015, was substantively enacted on 2 July 2013. This rate reduction has been reflected in the calculation of deferred tax at the balance sheet date.

**24. Provisions**

| £m | Reorganisation provisions | Insurance provision | Deferred consideration | Property provisions | Total |
|---|---|---|---|---|---|
| **Gross provision:** | | | | | |
| At 1 September 2013 | 1.4 | 1.4 | 1.9 | 6.4 | 11.1 |
| Additions | 0.7 | 0.2 | 0.2 | 1.3 | 2.4 |
| Released | (0.1) | – | – | (1.5) | (1.6) |
| Utilised in year | (1.3) | (0.2) | (2.1) | (2.6) | (6.2) |
| **At 31 August 2014** | **0.7** | **1.4** | – | **3.6** | **5.7** |
| **Discount:** | | | | | |
| At 1 September 2013 | – | – | – | (0.8) | (0.8) |
| Additions | – | – | – | (0.1) | (0.1) |
| Released | – | – | – | 0.4 | 0.4 |
| Unwinding of discount utilisation | – | – | – | 0.1 | 0.1 |
| **At 31 August 2014** | – | – | – | **(0.4)** | **(0.4)** |
| **Net book value at 31 August 2014** | **0.7** | **1.4** | – | **3.2** | **5.3** |
| **Gross provision:** | | | | | |
| At 1 September 2012 | 0.3 | 1.3 | 2.1 | 10.8 | 14.5 |
| Additions | 1.4 | 0.5 | 1.8 | 0.6 | 4.3 |
| Disposal | – | – | – | (0.9) | (0.9) |
| Utilised in year | (0.3) | (0.4) | (2.0) | (4.1) | (6.8) |
| **At 31 August 2013** | 1.4 | 1.4 | 1.9 | 6.4 | 11.1 |
| **Discount:** | | | | | |
| At 1 September 2012 | – | – | – | (2.0) | (2.0) |
| Additions | – | – | – | 0.2 | 0.2 |
| Unwinding of discount utilisation | – | – | – | 1.0 | 1.0 |
| **At 31 August 2013** | – | – | – | (0.8) | (0.8) |
| **Net book value at 31 August 2013** | 1.4 | 1.4 | 1.9 | 5.6 | 10.3 |

**20. Financial Instruments** continued

**Interest rate sensitivity analysis**

The sensitivity analysis below has been determined based on the exposure to interest rates for both derivative and non-derivative instruments at the balance sheet date. For floating rate liabilities the analysis assumes the amount of liability outstanding at the balance sheet date was outstanding for the whole year.

If interest rates had been 0.5% higher/lower and all other variables were held constant, the Group's profit and equity for the year ended 31 August 2014 would decrease/increase by £0.1m (2013: £0.4m) due to the interest rate swaps that are used to mitigate this risk.

**Credit risk**

The Group considers its exposure to credit risk at 31 August 2014 to be as follows:

| £m | **2014** | 2013 |
|---|---|---|
| Bank deposits | **20.4** | 10.1 |
| Trade receivables | **107.9** | 106.9 |
| | **128.3** | 117.0 |

Further detail on the Group's policy relating to trade receivables can be found in Note 17 to the accounts.

## 21. Obligations under finance leases

| | **2014** | | 2013 | |
|---|---|---|---|---|
| £m | **Minimum lease payments** | **Present value of minimum lease payments** | Minimum lease payments | Present value of minimum lease payments |
| **Amount payable under finance leases:** | | | | |
| Within one year | **1.0** | **1.0** | 1.0 | 1.0 |
| In the second to fifth years inclusive | **3.4** | **3.1** | 0.9 | 0.8 |
| **Total** | **4.4** | **4.1** | 1.9 | 1.8 |
| Less: future finance charges | **(0.3)** | **–** | (0.1) | – |
| **Present value of lease obligations** | **4.1** | **4.1** | 1.8 | 1.8 |
| Less: amount due for settlement within 12 months (shown under current liabilities) | | **(0.9)** | | (1.0) |
| **Amount due for settlement after 12 months** | | **3.2** | | 0.8 |

Group policy is to acquire certain items of its fixtures and equipment under finance leases. The average lease term is 3.5 years. Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

The fair value of the Group's lease obligations approximates to their carrying amount.

## 22. Other non-current liabilities

| £m | **2014** | 2013 |
|---|---|---|
| Other creditors | **1.4** | 1.6 |

The balance disclosed as other creditors within non-current liabilities relates to operating lease incentives which are being recognised over the lease term.

**20. Financial Instruments** continued

**Foreign currency risk**
- The Group does not hedge the translation effect of exchange rate movements on the Income Statement. The majority of the Group's transactions are however carried out in the functional currencies of its operations, and so transactional exposure is limited.
- The majority of the Group's net assets are held in Sterling, with only £3.9m (2013: £3.1m) of net assets held in overseas currencies. Translation exposure arises on the retranslation of overseas subsidiaries profits and net assets into Sterling for financial reporting purposes and is not seen as significant.
- Note 19 denotes borrowings by currency.
- There are no material currency exposures to disclose.

**Interest rate risk**
The Group regularly monitors its exposure to interest rate risk. The Group uses interest rate swaps to manage its exposure to interest rate movements on its bank borrowings. The Group avoids the use of derivatives or other financial instruments in circumstances when the outcome would effectively be largely dependent upon speculation on future rate movements. As at 31 August 2014, 100% of the Group's borrowings were at fixed rates achieved through hedging.

It is, and has been throughout the period of review, the Group's policy that no trading in derivative financial instruments shall be undertaken.

**Hedge accounting**
There are £60m of interest rate hedges in place until November 2014 and a further £60m in place until November 2017 contracted at an average effective rate of 3.5%.

Under interest rate swap contracts, the Group agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the Group to mitigate the cash flow exposures on the issued variable rate debt held. The fair value of interest rate swaps at the reporting date is based on the market values of equivalent instruments at the balance sheet date, and is disclosed below. The average interest rate is based on the outstanding balances at the end of the financial year.

The following table details the notional principal amounts and remaining terms of interest rate swap contracts outstanding as at the reporting date:

| | Average contract fixed interest rate | | Notional principal amount | | Fair value | |
|---|---|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| **Outstanding receive floating, pay fixed contracts** | | | | | | |
| Less than one year | **1.6%** | 1.6% | **£60.0m** | – | **(£0.3m)** | – |
| Two to five years | **1.0%** | 1.0% | **£60.0m** | £120.0m | **£0.9m** | (£0.4m) |

The interest rate swaps are settled on a monthly basis. The floating rate on the interest rate swaps is one month LIBOR. The Group settles the difference between fixed and floating interest rates on a net basis. All interest rate swap contracts exchanging floating rate interest amounts for fixed rate interest amounts are designated as cash flow hedges in order to reduce the Group's cash flow exposure resulting from variable interest rates on borrowings. The interest rate swaps and the interest payments on the loan occur simultaneously and the amount deferred in equity is recognised in the income statement over the period that the floating rate interest payments on debt impact the income statement.

All derivative financial instruments are classified as level 2 based upon the degree to which the fair value movements are observable. Level 2 fair value measurements are defined as those derived from inputs other than quoted prices that are observable for the asset or liability, either directly (prices from third parties) or indirectly (derived from third party prices).

| | Current | | Non-current | |
|---|---|---|---|---|
| £m | **2014** | 2013 | **2014** | 2013 |
| Derivatives that are designated and effective as hedging instruments carried at fair value: | | | | |
| Interest rate swaps – Liabilities | – | (0.8) | – | – |
| | – | (0.8) | – | – |
| Interest rate swaps – Assets | – | – | **0.6** | 0.4 |
| | – | (0.8) | **0.6** | 0.4 |

At 31 August 2014 it was determined that £50m of a £60m hedge put in place in September 2012 could not be designated within a hedge relationship as a result the movement of the fair value of this part of the hedge was recognised in the Income Statement, resulting in a £0.4m credit being recognised in finance costs with the remainder of the mark to market valuations being recognised in reserves.

**20. Financial Instruments** continued

**Liquidity risk**

The Group manages liquidity risk by maintaining adequate reserves and banking facilities and by monitoring forecast and actual cash flows. The facilities that the Group has at its disposal to further reduce liquidity risk are as follows:

As at 31 August 2014, the Group had £200m committed bank facilities in place (2013: £177m).

Bank facilities now comprise:
- a £50m syndicated term loan with £5m repayable in February 2017, August 2017, February 2018 and August 2018 with the balance repayable in November 2018;
- a £150m syndicated revolving credit facility which is expires in November 2018;

The facility described above is subject to the following covenants:
- Leverage cover – the net debt: adjusted EBITDA ratio which must remain below 2.75x. At 31 August 2014 the ratio was 1.4x
- Interest cover – the consolidated net interest: adjusted EBITDA ratio which must remain above 3.0x. As at 31 August 2014 the ratio was 11.8x
- Fixed charge cover – the ratio of adjusted EBITDA to consolidated fixed charges is not less than 2.0. As at 31 August 2014 the ratio was 4.7x
- Guarantor cover – The annual turnover, gross assets and pre-tax profits of the Guarantors contribute at any time 80% or more of the annual consolidated turnover, gross assets and pre-tax profits of the Group for each of its financial years. The guarantors, which are all 100% owned or wholly owned subsidaries of the Connect Group PLC, are Connect Group PLC, Dawson Holdings Limited, Hedgelane Limited, Smiths News Holdings Limited, Smiths News Investments Limited, Smiths News Trading Limited, Bertram Trading Limited, Connect2U Limited, The Consortium for Purchasing and Distribution Limited, Smiths News Instore Limited and Dawson Books Limited.

At 31 August 2014, the Group had available £90.7m (2013: £70.2m) of undrawn committed borrowing facilities. There were no breaches of loan agreements during either the current or prior years.

As the Group is cash generative its liquidity risk is considered low. The Group's cash generation allows it to meet all loan commitments as they fall due as well as sustain a negative working capital position.

The Group invests significant resources in the forecasting and management of its cash flows. This is critical given a routine cash cycle that results in significant predictable swings within each month of around £50m.

The following is an analysis of the undiscounted contractual cash flows payable under financial liabilities and derivatives. The undiscounted cash flows will differ from both the carrying value and fair value. Floating rate interest is estimated using the prevailing rate at the balance sheet date.

| £m | Due within one year | Due between one and two years | Due between two and three years | Greater than three years |
|---|---|---|---|---|
| **At 31 August 2014** | | | | |
| **Non derivative financial liabilities** | | | | |
| Bank and other borrowings | (62.0) | (1.1) | (10.9) | (41.1) |
| Finance leases | (0.9) | (1.1) | (1.2) | (1.2) |
| **Derivative and other financial liabilities** | | | | |
| Net settled derivative contracts – receipts | 0.1 | – | – | – |
| Net settled derivative contracts – payments | (0.3) | – | – | – |
| **Derivative and other financial assets** | | | | |
| Net settled derivative contracts – receipts | 0.3 | 0.3 | 0.3 | 0.1 |
| **Total** | **(62.8)** | **(1.9)** | **(11.8)** | **(42.2)** |

| £m | Due within one year | Due between one and two years | Due between two and three years | Greater than three years |
|---|---|---|---|---|
| **At 31 August 2013** | | | | |
| **Non derivative financial liabilities** | | | | |
| Bank and other borrowings | (72.8) | (34.0) | – | – |
| Finance leases | (1.0) | (0.8) | – | – |
| **Derivative and other financial liabilities** | | | | |
| Net settled derivative contracts – receipts | 0.3 | 0.1 | – | – |
| Net settled derivative contracts – payments | (1.3) | (0.3) | – | – |
| **Derivative and other financial assets** | | | | |
| Net settled derivative contracts – receipts | 0.2 | 0.2 | 0.2 | 0.2 |
| **Total** | **(74.6)** | **(34.8)** | **0.2** | **0.2** |

**Counterparty risk**

Dealings are restricted to those banks with suitable credit ratings and counterparty risk and credit exposure is monitored.

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the accounts continued

**17. Trade and other receivables** continued
Other debtors and prepayments

The largest items included within this balance are £7.6m (2013: £4.9m) of publisher debtors and £4.0m (2013: £4.5m) of accrued revenue.

**18. Trade and other payables**

| £m | 2014 | 2013 |
|---|---|---|
| Trade payables | **156.1** | 147.2 |
| Other tax and social security | **3.1** | 3.5 |
| Other creditors | **11.9** | 15.7 |
| Accruals and deferred income | **21.2** | 22.3 |
| | **192.3** | 188.7 |

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 30 days (2013: 26 days). No interest is charged on trade payables. The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

**19. Cash and borrowings**
Cash and borrowings by currency (Sterling equivalent) are as follows:

| £m | Sterling | Euro | US Dollar | Other | Total 2014 | 2013 |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | **17.7** | **1.8** | **0.4** | **0.5** | **20.4** | 10.1 |
| Term loan – disclosed within current liabilities | – | – | – | – | – | (3.0) |
| Term loan – disclosed within non-current liabilities | **(48.4)** | – | – | – | **(48.4)** | (34.0) |
| Revolving credit facility | **(59.0)** | **(1.9)** | – | – | **(60.9)** | (62.9) |
| Asset backed facility | – | – | – | – | – | (6.9) |
| Total borrowings | **(107.4)** | **(1.9)** | – | – | **(109.3)** | (106.8) |
| **Net borrowings** | **(89.7)** | **(0.1)** | **0.4** | **0.5** | **(88.9)** | (96.7) |
| **Total borrowings** | | | | | | |
| Amount due for settlement within 12 months | **(59.0)** | **(1.9)** | – | – | **(60.9)** | (72.8) |
| Amount due for settlement after 12 months | **(48.4)** | – | – | – | **(48.4)** | (34.0) |
| | **(107.4)** | **(1.9)** | – | – | **(109.3)** | (106.8) |

Cash and cash equivalents comprise cash held by the Group and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

Available Group bank facilities are outlined in Note 20. At 31 August 2014, the Group had £90.7m (2013: £70.2m) of undrawn committed borrowing facilities in respect of which all conditions precedents had been met. Interest payable under the current facility is calculated as the cost of one month LIBOR plus an interest margin of between 1.35% and 2.35% dependent on the net debt/adjusted EBITDA covenant ratio.

**20. Financial Instruments**
**Treasury policy**
The Group operates a centralised treasury function to manage the Group's funding requirements and financial risks in line with the Board approved treasury policies and procedures and their delegated authorities. Treasury's role is to ensure that appropriate financing is available for running the businesses of the Group on a day-to-day basis, allowing for investments and acquisitions whilst minimising interest cost. No transactions of a speculative nature are undertaken. Dealings are restricted to those banks with suitable credit ratings and counterparty risk and credit exposure is monitored frequently.

**Capital risk management**
The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The capital structure of the Group consists of debt, which includes the borrowings, cash and cash equivalents as disclosed in Note 19 and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in the Group Statement of Changes in Equity.

## 16. Inventories

| £m | 2014 | 2013 |
|---|---|---|
| Goods held for resale | **45.3** | 44.2 |

## 17. Trade and other receivables

| £m | 2014 | 2013 |
|---|---|---|
| Trade receivables | **107.9** | 107.6 |
| Allowance for doubtful debts | **(0.7)** | (0.7) |
| | **107.2** | 106.9 |
| Other debtors | **12.4** | 10.3 |
| Prepayments and accrued income | **8.5** | 9.9 |
| **Trade and other receivables** | **128.1** | 127.1 |

### Trade receivables

Total trade receivables net of allowances for doubtful debts held by the Group at 31 August 2014 amounted to £107.2m (2013: £106.9m), comprising the amounts presented above.

The average credit period taken on sale of goods is 21 days (2013: 19 days). Trade receivables are generally non-interest bearing. The Group provides for receivables on an individual customer basis based on circumstances known at that time and the likelihood of recovery.

Included in the outstanding trade receivables balance are debtors with overdue amounts of £8.5m (2013: £9.5m) that the Group has not provided for as these amounts are still considered recoverable and fall outside our pre-determined provisioning policy.

Ageing of past due but not impaired receivables:

| £m | 2014 | 2013 |
|---|---|---|
| 30–60 days | **5.3** | 6.0 |
| 61–90 days | **1.4** | 1.1 |
| 91–120 days | **0.6** | 0.9 |
| Over 120 days | **1.2** | 1.5 |
| | **8.5** | 9.5 |

Included within the 2014 number is an expected seasonal peak of £4.6m (2013: £4.6m) largely within the 30-60 day ageing relating to The Consortium business.

Of the trade receivables balance at the end of the year:

- One customer (2013: one) had an individual balance that represented more than 10% of the total trade receivables balance. The total of these were £15.3m (2013: £29.0m); and
- A further six customers (2013: three) had individual balances that represented more than 5% of the total trade receivables balance. The total of these was £42.2m (2013: £24.4m).

Movement in the allowance for doubtful debts:

| £m | 2014 | 2013 |
|---|---|---|
| At 1 September | **0.7** | 0.9 |
| Impairment losses recognised | **0.7** | 0.3 |
| Amounts written off as uncollectible | **(0.6)** | (0.4) |
| Amounts recovered during the year | **(0.1)** | (0.1) |
| At 31 August | **0.7** | 0.7 |

Ageing of past due and impaired trade receivables:

| £m | 2014 | 2013 |
|---|---|---|
| 30–60 days | **–** | – |
| 61–90 days | **0.1** | 0.1 |
| 91–120 days | **0.1** | 0.1 |
| Over 120 days | **0.5** | 0.5 |
| | **0.7** | 0.7 |

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

# Connect Group PLC (formerly Smiths News PLC)
## Notes to the accounts continued

### 14. Property, plant and equipment

| £m | Land and Buildings: Freehold properties | Land and Buildings: Long-term leasehold | Land and Buildings: Short-term leasehold | Fixtures and fittings | Equipment and vehicles | Total |
|---|---|---|---|---|---|---|
| **Cost:** | | | | | | |
| At 1 September 2013 | 4.9 | 0.4 | 11.9 | 7.3 | 38.7 | 63.2 |
| Additions | – | – | 0.5 | 1.3 | 5.8 | 7.6 |
| Disposals | – | – | (0.4) | (0.3) | (5.5) | (6.2) |
| **At 31 August 2014** | **4.9** | **0.4** | **12.0** | **8.3** | **39.0** | **64.6** |
| **Accumulated depreciation:** | | | | | | |
| At 1 September 2013 | 0.4 | 0.3 | 7.8 | 5.5 | 22.6 | 36.6 |
| Depreciation charge | 0.1 | – | 0.8 | 0.7 | 3.6 | 5.2 |
| Disposals | – | – | (0.4) | (0.3) | (5.5) | (6.2) |
| **At 31 August 2014** | **0.5** | **0.3** | **8.2** | **5.9** | **20.7** | **35.6** |
| **Net book value at 31 August 2014** | **4.4** | **0.1** | **3.8** | **2.4** | **18.3** | **29.0** |
| **Cost:** | | | | | | |
| At 1 September 2012 | 4.9 | 0.4 | 12.4 | 11.1 | 29.5 | 58.3 |
| Additions | – | – | 0.7 | 0.6 | 6.2 | 7.5 |
| Inter segment transfer | – | – | – | (4.1) | 4.1 | – |
| Disposals | – | – | (1.2) | (0.3) | (1.1) | (2.6) |
| **At 31 August 2013** | 4.9 | 0.4 | 11.9 | 7.3 | 38.7 | 63.2 |
| **Accumulated depreciation:** | | | | | | |
| At 1 September 2012 | 0.4 | 0.3 | 8.2 | 5.8 | 19.1 | 33.8 |
| Depreciation charge | – | – | 0.7 | 0.5 | 4.1 | 5.3 |
| Inter segment transfer | – | – | – | (0.5) | 0.5 | – |
| Disposals | – | – | (1.1) | (0.3) | (1.1) | (2.5) |
| **At 31 August 2013** | 0.4 | 0.3 | 7.8 | 5.5 | 22.6 | 36.6 |
| **Net book value at 31 August 2013** | 4.5 | 0.1 | 4.1 | 1.8 | 16.1 | 26.6 |

The Group leases plant and equipment under a number of finance lease arrangements and has the option to purchase the equipment at the end of each lease. The net book value of finance leases contained within these balances is £4.1m at 31 August 2014 (2013: £1.8m).

### 15. Interests in jointly controlled entities

The Group's share of the results, assets and liabilities of jointly controlled entities is as follows:

| £m | **2014** | 2013 |
|---|---|---|
| **Revenue** | **9.6** | 9.4 |
| **Profit after tax** | **0.3** | 0.2 |
| Non-current assets | **1.2** | 1.2 |
| Current assets | **2.6** | 2.2 |
| Total assets | **3.8** | 3.4 |
| Current liabilities | **(2.3)** | (1.9) |
| Non-current liabilities | **(0.1)** | (0.3) |
| Total liabilities | **(2.4)** | (2.2) |
| Goodwill | **2.9** | 2.9 |
| **Share of net assets** | **4.3** | 4.1 |

The jointly controlled entities of the Group are as follows:

**FMD Limited**
The Group has a 50% investment in FMD Limited, the holding company of Worldwide Magazine Distribution Limited, a company incorporated in England (2013: 50%). The latest statutory accounts of FMD Limited were drawn up to 30 April 2014.

**Rascal Solutions Limited**
The Group has a 50% interest in the ordinary shares of Rascal Solutions Limited, a company incorporated in England (2013: 50%). The latest statutory accounts of Rascal Solutions Limited were drawn up to 31 August 2013.

**Bluebox Avionics Limited**
The Group has a 50% interest in the ordinary shares of Bluebox Avionics Limited, a company incorporated in England (2013: 50%). The latest statutory accounts of Bluebox Avionics Limited were drawn up to 31 August 2013.

**11. Intangible assets** continued

Goodwill is not amortised, but tested annually for impairment or more frequently if there are indications that goodwill might be impaired with the recoverable amount being determined from value in use calculations. The recoverable amounts of the combined cash generating units are determined from the value in use calculations. The Group prepares cash flow forecasts derived from the most recent budgets and forecasts for the following three years as approved by the Board and extrapolates these cash flows on an estimated growth rate of 1% into perpetuity. The rate used to discount the forecast cash flows range from 13.5% to 13.9%, being the Group's risk adjusted pre-tax WACC, specific for each cash generating unit. Pre-tax discount rates are derived from the Group's post-tax WACC of 9% risk adjusted by 2%. The calculation of value in use is most sensitive to the discount rate and growth rates used. In analysing the sensitivity of key assumptions, management consider that potential changes in certain assumptions could cause the carrying value to fall below recoverable amount for Connect Books. Using the key assumptions stated above the value in use exceeded the carrying amount by £16.1m. An impairment would be recognised if the discount rate was 1.9% higher or if forecast cash flows were more than 34% lower.

Management believes that no other reasonable potential change in any of the above key assumptions would cause the carrying value to exceed its recoverable amount.

| | Goodwill | | | Acquired Intangibles | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| £m | **2014** | 2013 | On acquisition | **2014** | 2013 | On acquisition | **2014** | 2013 | On acquisition |
| **Connect Books** | **17.6** | 17.6 | 17.6 | **5.6** | 7.6 | 12.7 | **23.2** | 25.2 | 30.3 |
| **Connect Media** | **5.7** | 5.7 | 5.7 | **1.6** | 1.8 | 2.6 | **7.3** | 7.5 | 8.3 |
| **Connect News** | **–** | – | – | **0.2** | – | 0.3 | **0.2** | – | 0.3 |
| **Connect Education and Care** | **20.9** | 20.9 | 20.9 | **7.8** | 9.0 | 10.4 | **28.7** | 29.9 | 31.3 |
| | **44.2** | 44.2 | 44.2 | **15.2** | 18.4 | 26.0 | **59.4** | 62.6 | 70.2 |

The individual material intangible assets relate to the customer relationships acquired with Dawson Holdings PLC and Hedgelane Ltd. The carrying value of these assets at 31 August 2014 is £4.6m and £7.0m respectively with a remaining amortisation period of four and five years respectively.

**12. Acquisitions**

The Group acquired the trade and assets from Martin Lavell Ltd on 1 September 2013, a significant distributor in the Business-to-Business sector of newspaper and magazine supplies in London, for a consideration of £0.3m. The acquisition gives rise to the recognition of £0.3m intangible asset for customer relationships and contributed a profit before tax of £0.3m in year.

**13. Disposals**

**2014**

There were no disposals in the period.

**2013**

On 30 April 2013, the Group disposed of 100% of the share capital in Dawson Marketing Services Limited and its trading subsidiary MMC for £0.3m. Due to the nature and size of the business disposed investment, it has not been separately disclosed as a discontinued operation as defined by IFRS5 – Non Current Assets Held for Sale and Discontinued Operations.

MMC contributed £3.9m to revenue and £0.1m to the Group's operating profit in 2013.

## 11. Intangible assets
### 11a Intangible assets

| £m | Goodwill | Acquired Intangibles: Customer relationships | Acquired Intangibles: Trade name | Software | Internally generated development costs | Computer software costs | Total |
|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | |
| At 1 September 2013 | 44.2 | 21.7 | 3.0 | 0.7 | 5.6 | 25.3 | 100.5 |
| Additions | – | 0.3 | – | – | 1.6 | 1.9 | 3.8 |
| **Disposals** | – | – | – | – | (1.2) | (20.4) | (21.6) |
| **At 31 August 2014** | **44.2** | **22.0** | **3.0** | **0.7** | **6.0** | **6.8** | **82.7** |
| **Accumulated amortisation:** | | | | | | | |
| At 1 September 2013 | – | 5.6 | 0.9 | 0.5 | 3.5 | 21.8 | 32.3 |
| Amortisation charge | – | 2.4 | 0.5 | 0.1 | 1.6 | 1.2 | 5.8 |
| Impairment | – | 0.5 | – | – | – | – | 0.5 |
| Disposal | – | – | – | – | (1.2) | (20.4) | (21.6) |
| **At 31 August 2014** | – | **8.5** | **1.4** | **0.6** | **3.9** | **2.6** | **17.0** |
| **Net book value at 31 August 2014** | **44.2** | **13.5** | **1.6** | **0.1** | **2.1** | **4.2** | **65.7** |
| **Cost:** | | | | | | | |
| At 1 September 2012 | 43.1 | 19.7 | 2.9 | 0.7 | 3.9 | 24.9 | 95.2 |
| Additions | 0.3 | – | – | – | 1.7 | 1.2 | 3.2 |
| Acquisition of subsidiaries | 0.8 | 2.3 | 0.1 | – | – | – | 3.2 |
| Disposals | – | (0.3) | – | – | – | (0.8) | (1.1) |
| **At 31 August 2013** | **44.2** | **21.7** | **3.0** | **0.7** | **5.6** | **25.3** | **100.5** |
| **Accumulated amortisation:** | | | | | | | |
| At 1 September 2012 | – | 3.4 | 0.6 | 0.3 | 2.3 | 21.5 | 28.1 |
| Amortisation charge | – | 2.3 | 0.3 | 0.2 | 1.2 | 1.0 | 5.0 |
| Disposal | – | (0.1) | – | – | – | (0.7) | (0.8) |
| **At 31 August 2013** | – | **5.6** | **0.9** | **0.5** | **3.5** | **21.8** | **32.3** |
| **Net book value at 31 August 2013** | **44.2** | **16.1** | **2.1** | **0.2** | **2.1** | **3.5** | **68.2** |

In the year the Group acquired the trade and assets of Martin Lavell giving rise to the recognition of an intangible asset of £0.3m for customer relationships.

In the prior year the £2.3m of additions to customer relationships is primarily £2.0m in relation to the acquisition of certain European and African academic library services customer relationships from Blackwell UK Limited on 20 May 2013 by Dawson Books Limited, a 100% owned subsidiary of the Group. The remaining £0.3m related to the Erasmus acquisition.

**11b. Goodwill and intangibles by segment and CGU**

Goodwill of £4.1m and acquired intangibles totalling £5.1m arose from the acquisition of the business and assets of Bertrams on 20 March 2009 have been allocated to the Connect Books combined cash generating unit (CGU).

The acquisition of Dawson Holdings PLC on 23 August 2011, resulted in goodwill of £18.1m and acquired intangibles of £7.8m. These have been *allocated to the two remaining individual CGU's identified at the time of the acquisition; Dawson Books and Media Direct.*

On the acquisition of Hedgelane Limited on 24 April 2012, the Group recognised goodwill of £20.9m and acquired intangibles of £10.4m which have been allocated to the Education and Care CGU.

The acquisition of 100% of the issued share capital of Houtschild Internationale Boekhandel B.V. on 13 June 2012 produced a further £0.3m of goodwill.

The acquisition of Erasmus on 17 January 2013 generated £0.8m of goodwill and £0.3m of acquired intangible assets.

The acquisition of certain Blackwell contracts on 16 April 2013 generated £2.0m of acquired intangibles.

The acquisition of trade and assets of Martin Lavell acquired on 1 September 2013 generated acquired intangibles of £0.3m.

During the year the original useful economic lives of customer relationship and trade names were reviewed and reduced from ten years to a maximum of 7.5 years based upon managements revised assessment of future contractual renewal rates. The impact in the current year was an additional amortisation charge of £0.6m.

**8. Income tax expense** continued

**Tax charges to other comprehensive income and directly in equity**

| £m | **2014** | 2013 |
|---|---|---|
| Current tax relating to the defined benefit pension scheme | **0.7** | 0.6 |
| Current tax relating to share-based payments | **0.5** | – |
| Deferred tax relating to derivative financial instruments | **(0.1)** | (0.3) |
| Deferred tax relating to share-based payments | **0.5** | 0.5 |
| Deferred tax relating to retirement benefit obligations | **(0.6)** | (3.3) |
| Tax charges to other comprehensive income | **1.0** | (2.5) |

1 Restatement in respect of retirement benefit obligations, see Note 34.

**9. Dividends**

Amounts paid and proposed as distributions to equity shareholders in the years:

| | **2014 Per share** | 2013 Per share | **2014 £m** | 2013 £m |
|---|---|---|---|---|
| **Paid and proposed dividends for the year** | | | | |
| Interim dividend – paid | **3.1p** | 3.0p | **5.8** | 5.5 |
| Final dividend – proposed | **6.6p** | 6.3p | **12.3** | 11.6 |
| | **9.7p** | 9.3p | **18.1** | 17.1 |

| | | | | |
|---|---|---|---|---|
| **Recognised dividends for the year** | | | | |
| Final dividend – prior year | **6.3p** | 5.8p | **11.9** | 10.5 |
| Interim dividend – current year | **3.1p** | 3.0p | **5.8** | 5.5 |
| | **9.4p** | 8.8p | **17.7** | 16.0 |

The proposed final dividend for the year ended 31 August 2014 of 6.6p is subject to approval by shareholders at the Annual General Meeting on 4 February 2015 and in line with IAS10 – 'Events after the reporting period', this dividend has not been included as a liability in these accounts. The proposed dividend, if approved, will be paid on 6 February 2015 to shareholders on the register at close of business on 9 January 2015.

**10. Earnings per share**

| | **2014** | | | 2013 Restated[1] | | |
|---|---|---|---|---|---|---|
| | **£m Earnings** | **Weighted average number of shares million** | **Pence per share** | £m Earnings | Weighted average number of shares million | Pence per share |
| Weighted average number of shares in issue | | **187.7** | | | 183.9 | |
| Shares held by the ESOP (weighted) | | **(1.4)** | | | (1.7) | |
| **Basic earnings per share (EPS)** | | | | | | |
| **Underlying earnings attributable to ordinary shareholders** | **40.5** | **186.3** | **21.7p** | 38.4 | 182.2 | 21.1p |
| Non-recurring and other items | **(5.9)** | | | (9.7) | | |
| **Earnings attributable to ordinary shareholders** | **34.6** | **186.3** | **18.6p** | 28.7 | 182.2 | 15.7p |
| **Diluted earnings per share (EPS)** | | | | | | |
| Effect of dilutive share options | | **6.3** | | | 11.7 | |
| **Diluted underlying EPS** | **40.5** | **192.6** | **21.0p** | 38.4 | 193.9 | 19.8p |
| **Diluted EPS** | **34.6** | **192.6** | **18.0p** | 28.7 | 193.9 | 14.8p |

1 Restatement in respect of retirement benefit obligations, see Note 34.

The acquisition of Hedgelane Limited in April 2012 included £4.0 million of deferred share capital payable contingent on profit targets and the continued employment of the former owners of Hedgelane Limited. In January 2014, 4.5 million shares were allotted in satisfaction of the deferred share capital. The weighted effect of this has been included in diluted EPS.

# Connect Group PLC (formerly Smiths News PLC)
## Notes to the accounts continued

**6. Retirement benefit obligation** continued
**Defined contribution schemes**
The Group operates a number of defined contribution schemes. For the year ended 31 August 2014, Company contributions totalled £2.8m (2013: £3.1m) which is included in the Income Statement.

A defined contribution plan is a pension plan under which the Group pays contributions to an independently administered fund – such contributions are based upon a fixed percentage of employees' pay. The Group has no legal or constructive obligations to pay further contributions to the fund once the contributions have been paid. Members' benefits are determined by the amount of contributions paid by the Company and the member, together with investment returns earned on the contributions arising from the performance of each individual's chosen investments and the type of pension the member chooses to buy at retirement. As a result, actuarial risk (that benefits will be lower than expected) and investment risk (that assets invested in will not perform in line with expectations) fall on the employee.

**7. Investment revenue and finance costs**

| £m | Note | 2014 | 2013 Restated[1] |
|---|---|---|---|
| Net change in fair value of derivative assets | | **0.4** | 0.3 |
| **Investment revenue** | | **0.4** | 0.3 |
| Interest on bank overdrafts and loans | | **(4.7)** | (4.7) |
| Net interest expense on defined benefit obligation | 6 | **(0.9)** | (1.6) |
| Interest payable on finance leases | | **(0.2)** | (0.2) |
| Unwinding of discount on provisions – trading | | **(0.1)** | (0.3) |
| **Underlying finance costs** | | **(5.9)** | (6.8) |
| **Underlying net finance costs** | | **(5.5)** | (6.5) |
| Unwinding of discount on provisions – non-recurring | | **–** | (0.2) |
| **Net finance costs** | | **(5.5)** | (6.7) |

1 Restatement in respect of retirement benefit obligations, see Note 34.

**8. Income tax expense**

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| £m | **Underlying** | **Non-recurring and other items** | **Total** | Restated[1] Underlying | Non-recurring and other items | Total |
| Current tax | **12.3** | **(1.0)** | **11.3** | 15.1 | (1.3) | 13.8 |
| Adjustment in respect of prior year UK corporation tax | **(2.4)** | **–** | **(2.4)** | (2.6) | – | (2.6) |
| **Total current tax charge** | **9.9** | **(1.0)** | **8.9** | 12.5 | (1.3) | 11.2 |
| Deferred tax – current year | **(0.4)** | **–** | **(0.4)** | (0.7) | – | (0.7) |
| Deferred tax – prior year | **(0.2)** | **–** | **(0.2)** | (0.3) | – | (0.3) |
| **Total tax on profit** | **9.3** | **(1.0)** | **8.3** | 11.5 | (1.3) | 10.2 |
| *Effective tax rate* | ***18.7%*** | | ***19.4%*** | *23.0%* | | *26.2%* |

The effective underlying income tax rate for the year was 18.7% (2013: 23.0%). After adjusting for the impact of non-recurring and other items of £1.0m (2013: £1.3m), the effective statutory income tax rate was 19.4% (2013: 26.2%).

The tax rates used in the 2014 and 2013 reconciliations of the tax charge are the main rates of UK corporation tax, those being 22.2% (2013: 23.6%).

**Reconciliation of the tax charge**

| £m | 2014 | Restated[1] 2013 |
|---|---|---|
| **Profit before tax** | **43.1** | 38.9 |
| Tax on profit at the standard rate of UK corporation tax 22.2% (2013: 23.6%) | **9.5** | 9.2 |
| Permanent differences | **1.3** | 2.9 |
| Share schemes | **(0.2)** | (0.4) |
| Adjustment in respect of prior year UK corporation tax | **(2.6)** | (2.9) |
| Impact of overseas tax rates | **0.3** | 1.4 |
| **Total tax charge** | **8.3** | 10.2 |

**6. Retirement benefit obligation** continued

The assets held in the swap financing portfolio provide a swap-based hedge against the change in value of a proportion of the Trust's liabilities for changes in long-term interest rates and inflation expectations.

The actual return on scheme assets during 2014 was a gain of £65.2m (2013: a gain of £45.5m).

The value of the assets held by the trust in Connect Group PLC issued financial instruments is nil (2013: nil).

Sensitivity of results to changes in the main assumptions:

| Assumption | Change in assumption | Impact on IAS19 liabilities |
|---|---|---|
| Discount rate | Decrease by 0.5% p.a. | Increase by £41m |
| Rate of inflation | Increase by 0.5% p.a. | Increase by £36m |
| Life expectancy | Increase by 1 year | Increase by £16m |

The sensitivity analysis for each significant actuarial assumption has been determined based on reasonably possible changes to the assumptions at the end of the reporting period. It is based on a change in the key assumption while holding all other assumptions constant. The effect of a change in more than one assumption will be different to the sum of the individual changes. When calculating the sensitivities, the same methodology used to calculate the liability recognised in the balance sheet has been applied. The methodology and types of assumptions used in preparing the sensitivity analysis is consistent with the previous period.

The history of experience adjustments is as follows:

| £m | **2014** | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Present value of defined benefit obligation | **(450.7)** | (419.2) | (395.3) | (348.3) | (367.4) |
| Fair value of assets | **522.7** | 469.6 | 433.1 | 375.1 | 408.6 |
| Impact of IFRIC 14 on defined benefit pension schemes | **(93.0)** | (73.5) | (73.8) | (63.1) | (41.2) |
| **Net deficit in the schemes** | **(21.0)** | (23.1) | (36.0) | (36.3) | – |
| Experience adjustments on scheme liabilities | **0.8** | (1.4) | (1.0) | (4.1) | (1.4) |
| Experience adjustments on scheme assets | **44.6** | 27.9 | 34.0 | (45.8) | 39.1 |

The cumulative amount of actuarial gains and losses recognised in the statement of comprehensive income since the adoption of IFRS is a loss of £21.4m (2013: a loss of £36.2m restated).

The Group's defined benefit pension plans have a number of areas of risk, the most significant of which and they ways in which the Group has sought to manage them are set out below:

| Risk | Description |
|---|---|
| Changes in bond yields | Falling bond yields tend to increase the funding and accounting liabilities.<br><br>The assets held in the swap financing portfolio of the Trust provide a swap-based hedge against the change in value of a proportion of the Trust's liabilities for changes in long-term interest rates and inflation expectations, reducing the exposure to changes in bond yields.<br><br>The Care and Platinum schemes both hold investments in corporate and government bonds which offer a degree of matching, i.e. the movement in assets arising from changes in bond yields partially matches the movement in the funding or accounting liabilities. In this way, the exposure to movements in bond yields is reduced. |
| Inflation risk | The plans' benefit obligations are linked to inflation and higher inflation will lead to higher liabilities (although in most cases caps on the level of inflationary increases are in place to protect the plan against extreme inflation).<br><br>The assets held in the swap financing portfolio of the Trust provide a swap-based hedge against the change in value of a proportion of the Trust's liabilities for changes in long-term interest rates and inflation expectations, reducing the exposure to inflation.<br><br>For the Care and Platinum schemes the majority of the assets are either unaffected by inflation (fixed interest bonds) or loosely correlated with inflation (equities), meaning that an increase in inflation will also increase the deficit. |
| Life expectancy | The majority of the plans' obligations are to provide a pension for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities. |

**6. Retirement benefit obligation** continued

A summary of the movements in the net balance sheet asset/(liability) and amounts recognised in the Group Income Statement and Other Comprehensive Income are as follows:

| £m | Fair value of scheme assets | Defined benefit obligation | Impact of IFRIC 14 on defined benefit pension schemes | Net asset/ (liability) on balance sheet |
|---|---|---|---|---|
| **At 31 August 2012** | 433.1 | (395.3) | (73.8) | (36.0) |
| Current service cost | – | (0.4) | – | (0.4) |
| Net interest cost- Restated[1] | 17.6 | (16.1) | (3.1) | (1.6) |
| **Total amount recognised in income statement – Restated[1]** | **17.6** | **(16.5)** | **(3.1)** | **(2.0)** |
| Actual less expected return on scheme assets | 27.9 | – | – | 27.9 |
| Actuarial losses arising from experience | – | (1.4) | – | (1.4) |
| Actuarial loss arising from changes in financial assumptions | – | (21.6) | – | (21.6) |
| Actuarial loss arising from changes in demographic assumptions | – | (0.4) | – | (0.4) |
| Change in surplus not recognised – Restated[1] | – | – | 3.4 | 3.4 |
| **Amount recognised in other comprehensive income** | **27.9** | **(23.4)** | **3.4** | **7.9** |
| Employer contributions | 7.0 | – | – | 7.0 |
| Benefit payments | (16.0) | 16.0 | – | – |
| **Amounts included in cash flow statement** | **(9.0)** | **16.0** | – | **7.0** |
| **At 31 August 2013** | **469.6** | **(419.2)** | **(73.5)** | **(23.1)** |
| Current service cost | (1.3) | 1.2 | – | (0.1) |
| Net interest cost | 20.6 | (18.2) | (3.3) | (0.9) |
| **Total amount recognised in income statement** | **19.3** | **(17.0)** | **(3.3)** | **(1.0)** |
| Actual less expected return on scheme assets | 44.6 | – | – | 44.6 |
| Actuarial losses arising from experience | – | 0.8 | – | 0.8 |
| Actuarial loss arising from changes in financial assumptions | – | (33.3) | – | (33.3) |
| Actuarial loss arising from changes in demographic assumptions | – | 2.6 | – | 2.6 |
| Change in surplus not recognised | – | – | (16.2) | (16.2) |
| **Amount recognised in other comprehensive income** | **44.6** | **(29.9)** | **(16.2)** | **(1.5)** |
| Employer contributions | 4.6 | – | – | 4.6 |
| Benefit payments | (15.4) | 15.4 | – | – |
| **Amounts included in cash flow statement** | **(10.8)** | **15.4** | – | **4.6** |
| **At 31 August 2014** | **522.7** | **(450.7)** | **(93.0)** | **(21.0)** |
| **Included within Non-current assets** | | | | **0.3** |
| **Included within Current liabilities** | | | | **(4.1)** |
| **Included within Non-current liabilities** | | | | **(17.2)** |

1 Restatement in respect of retirement benefit obligations, see Note 34.

The charge for the current service cost is included within administrative expenses. 'Net interest costs' are calculated by applying a discount rate to the net defined benefit asset or liability scheme assets and are included within finance income and expense.

An analysis of the assets at the balance sheet date is detailed below:

| £m | | **2014** | 2013 |
|---|---|---|---|
| Swap financing portfolio[1] | Unquoted | **477.0** | 439.1 |
| Interest rate and inflation swaps | Unquoted | **6.2** | (11.8) |
| Loan fund[2] | Unquoted | **24.2** | – |
| Equity call options[3] | Unquoted | – | 27.9 |
| Equities (CARE) | Unquoted | **10.4** | 10.2 |
| Bonds (CARE, Platinum) | Unquoted | **4.7** | 4.2 |
| Cash (CARE) | | **0.2** | – |
| | | **522.7** | 469.6 |

1 Investments with the aim of generating a return above LIBOR to finance the interest and inflation swaps in the Pension Trust. At 31 August 2014 this comprised £270m in asset and total return swap contracts and £180m in a fund comprising a range of assets from government bonds to hedge funds that targets a return above LIBOR.
2 The loan fund looks to generate a return over a portfolio of loans.
3 The equity option portfolio as at 31 August 2013 represented a notional upside exposure to equities of around £140m.

**6. Retirement benefit obligation** continued
The primary defined benefit pension scheme (the Smiths News Section of the WH Smith Pension Trust) has an IAS19 surplus of £75.7m at 31 August 2014 (2013: £53.2m surplus) which the Group does not recognise in the accounts as the investment policy being used means that the amount available on a reduction of future contributions is expected to be £nil (2013: £nil). The valuation of the defined benefit schemes for the IAS19 disclosures have been carried out by independent qualified actuaries based on updating the most recent funding valuations of the respective schemes, adjusted as appropriate for membership experience and changes in the actuarial assumptions.

The actuarial valuation for funding purposes produces a scheme deficit due to different assumptions and calculation methodologies used compared to those under IAS19, most notably the use of a discount rate that reflects the actual investment strategy, rather than corporate bond yields as required under IAS19.

In the prior year the triennial actuarial valuation of the Smiths News section of the WH Smith Pension Trust, effective 31 March 2012 was agreed at a liability of £33.0m. The deficit in the scheme was £23.0m when last estimated at 19 June 2013, reduced from £50.0m at the last valuation date of March 2009. The next valuation date for the scheme will be 31 March 2015.

Future cash contributions by the Group to address this reduced deficit will be £4.1m per annum through to March 2019. The Group recognises the present value of these agreed contributions as a pension liability of £17.3m (FY2013: £20.3m).

IAS19 (Revised) has been adopted in the year ended 31 August 2014. This required a change in accounting policy to reflect pension interest in the income statement calculated on the net balance sheet position at the beginning of the period. The resulting non-cash pension charge for the period ended 31 August 2014 was £0.9m. The prior period for the year ended 31 August 2013 was restated as described in Note 34.

**Other defined benefit schemes**
For the Consortium CARE and Platinum schemes, the Group contributed £0.4m in 2014. The next funding valuation of the Consortium CARE scheme was due on 31 December 2013 and has not yet been finalised. The results of the Platinum scheme's 31 December 2012 funding valuation are not yet finalised.

Across all three of the Groups' schemes the expected level of contributions for FY2015 is £4.9m.

The weighted average duration of the schemes is 18 years for the Pension Trust, 21 years for the Consortium Care scheme and 31 years for the Platinum scheme.

The principal long-term assumptions used to calculate scheme liabilities on all Group schemes are:

| **% p.a.** | **2014** | | 2013 | |
|---|---|---|---|---|
| Discount rate | **3.85** | | 4.45 | |
| Inflation assumptions – CPI | **2.25** | | 2.45 | |
| Inflation assumptions – RPI | **3.25** | | 3.45 | |
| **Life expectancy at age 65** | Male | Female | Male | Female |
| Member currently aged 65 | 21.7 | 23.9 | 21.9 | 24.1 |
| Member currently aged 45 | 23.1 | 25.4 | 23.2 | 25.6 |

**4. Non-recurring and other items** continued
**(f) Disposal of MMC**
On 1 May 2013, the Group disposed of 100% of the share capital in Dawson Marketing Services Limited and its trading subsidiary Marketlink Marketing Communications Limited (MMC) for £0.3m. Due to the nature and size of the business disposed investment, it has not been separately disclosed as a discontinued operation as defined by IFRS5 – Non Current Assets Held for Sale and Discontinued Operations.

MMC contributed £3.9m to revenue and £0.1m to the Group's operating profit in 2013.

**5. Staff costs and employees**
**(a) Staff costs**
The aggregate remuneration of employees (including executive directors) was:

| £m | Note | **2014** | 2013 Restated |
|---|---|---|---|
| Wages and salaries | | **82.5** | 81.2 |
| Social security | | **6.6** | 6.5 |
| Pension costs | 6 | **2.8** | 3.1 |
| Share-based payments | 31 | **1.5** | 1.9 |
| **Total** | | **93.4** | 92.7 |

Pension costs shown above exclude charges and credits for pension scheme financing and actuarial gains and losses arising on the pension scheme.

For comparability, prior year has been restated to exclude costs of £10.9m for individuals not directly under contracts of service.

**(b) Employee numbers**
The average total monthly number of employees (including executive directors) was:

| Number | **2014** | 2013 |
|---|---|---|
| Operations | **3,446** | 4,036 |
| Support functions | **932** | 758 |
| **Total** | **4,378** | 4,794 |

**6. Retirement benefit obligation**
**Defined benefit pension schemes**
The Group operates three defined benefit schemes, of which the WH Smith Pension Trust (the Pension Trust) represents over 96% of the total obligation at 31 August 2013. As part of the acquisition of the Consortium, the Group acquired the assets and liabilities in respect of two other defined benefit schemes (the 'Consortium CARE' and 'Platinum' schemes).

The Group's defined benefit pension plans are final salary pension plans, which provide benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' length of service and their salary in the final years leading up to retirement. Benefits are paid to members from trustee-administered funds, the trustees are responsible for ensuring that the plan is sufficiently funded to meet current and future benefit payments. If investment experience is worse than expected, the Group's obligations are increased.

The trustees must agree a funding plan with the sponsoring company such that any funding shortfall is expected to be met by additional contributions and investment performance. In order to assess the level of contributions required, triennial valuations are carried out with plan's obligations measured using prudent assumptions (relative to those used to measure accounting liabilities). The trustees' other duties include managing the investment of plan assets, administration of plan benefits and exercising of discretionary powers.

The amounts recognised in the balance sheet are as follows:

| £m | **WH Smith Pension Trust** | **The Consortium CARE** | **Platinum** | **2014** | WH Smith Pension Trust | The Consortium CARE | Platinum | 2013 |
|---|---|---|---|---|---|---|---|---|
| Present value of defined benefit obligation | **(431.6)** | **(18.4)** | **(0.6)** | **(450.6)** | (402.1) | (16.8) | (0.3) | (419.2) |
| Fair value of assets | **507.3** | **14.4** | **0.9** | **522.6** | 455.3 | 13.8 | 0.5 | 469.6 |
| **Net surplus** | **75.7** | **(4.0)** | **0.3** | **72.0** | 53.2 | (3.0) | 0.2 | 50.4 |
| Amounts not recognised due to asset limit | **(75.7)** | **–** | **–** | **(75.7)** | (53.2) | – | – | (53.2) |
| | **–** | **(4.0)** | **0.3** | **(3.7)** | – | (3.0) | 0.2 | (2.8) |
| Additional liability recognised due to minimum funding requirements | **(17.3)** | **–** | **–** | **(17.3)** | (20.3) | – | – | (20.3) |
| **Pension liability** | **(17.3)** | **(4.0)** | **–** | **(21.3)** | (20.3) | (3.0) | – | (23.3) |
| **Pension asset** | **–** | **–** | **0.3** | **0.3** | – | – | 0.2 | 0.2 |

**3. Operating profit** continued
Details of the Company's policy on the use of auditors for non-audit services and how the auditor's independence and objectivity was safeguarded are set out in the Audit Committee report on page 38. In the current year the Group incurred £0.1m of non-audit fees with Deloitte relating to remuneration advice and other advisory services.

In the current year the Group incurred £0.1m of non-audit fees with Deloitte relating to remuneration advice and other advisory services.

During the prior year the Group commissioned an extension of the digital strategy review of the books market to consider technology and market entry strategies. After careful consideration of proposals from a number of providers the Board appointed a Deloitte digital strategy team based on market understanding, service and price.

**4. Non-recurring and other items**

| £m | Note | 2014 | 2013[1] Restated |
|---|---|---|---|
| Integration costs | | – | (1.1) |
| Network reorganisation costs | (a) | **(3.0)** | (3.3) |
| Acquisition and disposal costs | (b) | **(0.9)** | (3.7) |
| Release of property provisions | (c) | **0.5** | – |
| Impairment | (d) | **(0.5)** | – |
| Amortisation of acquired intangibles | (e) | **(3.0)** | (2.8) |
| Disposal of MMC | (f) | – | 0.1 |
| **Total before, finance costs and taxation** | | **(6.9)** | (10.8) |
| Finance costs | | – | (0.2) |
| **Total before taxation** | | **(6.9)** | (11.0) |
| Income tax expense | | **1.0** | 1.3 |
| **Total after taxation** | | **(5.9)** | (9.7) |

1 Restatement in respect of retirement benefit obligations, see Note 34.

The Group incurred a total of £5.9m (2013: £9.7m) in non-recurring and other costs, after tax. This comprises:

**(a) Network reorganisation costs**
Network reorganisation costs of £3.0m have been incurred across the Group. The largest elements of which relate to the network restructuring programme within Connect News and Media. In addition cost reduction actions taken within Connect Books resulted in a cost of £0.5m. The largest cost category was redundancy costs of £1.6m.

**(b) Acquisition and disposal costs**
Acquisition and disposal costs of £0.9m relate primarily to reviewing and targeting future acquisitions, together with the final apportionment of deferred consideration from the acquisition of The Consortium in April 2012 and costs associated with the acquisition of Martin Lavell in September 2013.

In the prior year acquisition costs of £3.7m have been incurred including The Consortium acquisition deferred consideration of £3.2m which has been recognised in the Income Statement, the costs having been spread over the earn out periods at the expected payout levels given the business' strong profit performance. Acquisition and new venture set up costs in respect of Erasmus, selected contracts from Blackwell Books Limited and Bertrams direct to consumer proposition were £0.5m.

**(c) Release of property provisions**
During the year the Group has released £0.5m relating to the historical property reversionary lease provisions following the settlement of two historical claims.

**(d) Impairment**
During the year we have reviewed the carrying value of acquired intangibles from the acquisition of Blackwell customer relationships in the Books division and as a result of lower than anticipated sales conversion we have written off £0.5m.

**(e) Amortisation of acquired intangibles**
Amortisation of acquired intangibles of £3.0m has been incurred relating to acquisitions amortised over their expected economic lives for which there is no ongoing cash impact. This leaves a further £15.2m net book value to be amortised over future years. During the year the estimated useful economic lives of Customer Relationships and Trade Names have been reviewed and have been reduced from a maximum of ten years to a maximum of 7.5 years. As a result an incremental amortisation charge of £0.6m has been incurred in the year.

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the accounts continued

**2. Segmental analysis** continued
**Geographical analysis**

| £m | Revenue by destination 2014 | Revenue by destination 2013 | Non-current assets by location of operation 2014 | Non-current assets by location of operation 2013 |
|---|---|---|---|---|
| United Kingdom | **1,729.9** | 1,734.4 | **98.6** | 98.7 |
| Europe | **51.2** | 47.9 | **0.2** | 0.2 |
| Rest of World | **27.4** | 28.5 | **–** | – |
| **Consolidated total** | **1,808.5** | 1,810.8 | **98.8** | 98.9 |

**3. Operating profit**
The Group's results are analysed as follows:

| £m | Note | 2014 Underlying | 2014 Non-recurring | 2014 Total | Restated 2013[1] Underlying | Restated 2013[1] Non-recurring | Restated 2013[1] Total |
|---|---|---|---|---|---|---|---|
| **Revenue** | | **1,808.5** | **–** | **1,808.5** | 1,806.9 | 3.9 | 1,810.8 |
| Cost of inventories recognised as an expense | | **(1,607.7)** | **–** | **(1,607.7)** | (1,606.2) | – | (1,606.2) |
| Write down of inventories recognised as an expense | | **(0.6)** | **–** | **(0.6)** | – | – | – |
| Other cost of sales | | **(1.2)** | **–** | **(1.2)** | (0.1) | (2.2) | (2.3) |
| **Cost of sales** | | **(1,609.5)** | **–** | **(1,609.5)** | (1,606.3) | (2.2) | (1,608.5) |
| **Gross profit** | | **199.0** | **–** | **199.0** | 200.6 | 1.7 | 202.3 |
| **Distribution costs** | | **(73.9)** | **–** | **(73.9)** | (81.0) | (2.9) | (83.9) |
| Administrative expenses | | **(65.6)** | **(3.4)** | **(69.0)** | (59.3) | (6.8) | (66.1) |
| Share-based payment expense | 31 | **(1.5)** | **–** | **(1.5)** | (1.9) | – | (1.9) |
| Amortisation of intangibles | 11 | **(2.8)** | **(3.0)** | **(5.8)** | (2.2) | (2.8) | (5.0) |
| Impairment | 11 | **–** | **(0.5)** | **(0.5)** | – | – | – |
| **Administrative expenses** | | **(69.9)** | **(6.9)** | **(76.8)** | (63.4) | (9.6) | (73.0) |
| Share of profits from jointly controlled entities | 15 | **0.3** | **–** | **0.3** | 0.2 | – | 0.2 |
| **Operating profit** | | **55.5** | **(6.9)** | **48.6** | 56.4 | (10.8) | 45.6 |

1 Restatement in respect of retirement benefit obligations, see Note 34.

The operating profit is stated after charging/(crediting):

| £m | Note | 2014 | 2013 |
|---|---|---|---|
| Depreciation on property, plant and equipment | 14 | **5.2** | 5.3 |
| Amortisation of intangible assets | 11 | **5.8** | 5.0 |
| Operating lease charges | | | |
| – occupied land and buildings | | **8.5** | 8.9 |
| – vacant land and buildings | | **0.5** | 0.9 |
| – equipment and vehicles | | **0.8** | 2.2 |
| Operating lease rental income – land and buildings | | **(0.1)** | (0.4) |
| Loss on disposal of fixed assets | | **–** | 0.2 |
| Staff costs | 5 | **93.4** | 103.6 |

Included in administrative expenses are amounts payable to Deloitte LLP and their associates by the Company and its subsidiary undertakings in respect of audit and non-audit services which are as follows:

| £m | 2014 | 2013 |
|---|---|---|
| Fees payable to the Company's auditor for the audit of the Company's annual accounts | **0.1** | 0.1 |
| Fees payable to the Company's auditor for the audit of the Company's subsidiaries | **0.2** | 0.2 |
| Total audit fees | **0.3** | 0.3 |
| Digital strategy review | **–** | 0.3 |
| Other services | **0.1** | 0.1 |
| Total non-audit fees | **0.1** | 0.4 |
| Total fees | **0.4** | 0.7 |

## 2. Segmental analysis

In accordance with IFRS8 'Operating Segments', Group management has identified its operating segments. The performance of these operating segments is reviewed, on a monthly basis, by the Board. The Board monitors the tangible, intangible and financial assets attributable to each segment to determine the allocation of resources and the performance of each segment.

These operating segments are:

| | |
|---|---|
| Connect News & Media: News Distribution (referred to as Smiths News) | The UK market leading distributor of newspapers and magazines to 30,000 retailers across England and Wales from 43 distribution centres. |
| Connect News & Media: Media (referred to as DMD) | A supplier of newspaper and magazines to airlines and a provider of inflight services. |
| Connect Books (referred to as Bertrams, Dawson Books and Wordery) | A leading UK distributor of physical and digital books to high street and online retailers, public libraries, academic institutions and direct to consumers with a strong international presence, supplying 100 countries. |
| Connect Education and Care (referred to as The Consortium) | A leading distributor of education and care consumable products servicing 30,000 customers across the UK. |

The following is an analysis of the Group's revenue and results by reportable segment:

| £m | Revenue 2014 | Revenue 2013[1] Restated | Operating profit 2014 | Operating profit 2013[1] Restated |
|---|---|---|---|---|
| Connect News & Media: News Distribution | **1,524.8** | 1,529.3 | **42.9** | 40.0 |
| Connect News & Media: Media | **25.1** | 25.9 | **2.3** | 1.8 |
| Connect Books | **193.7** | 187.9 | **2.5** | 7.2 |
| Connect Education and Care | **64.9** | 63.8 | **7.8** | 7.4 |
| **Total group – underlying** | **1,808.5** | 1,806.9 | **55.5** | 56.4 |
| Non-recurring and other items (Note 4) | **–** | 3.9 | **(6.9)** | (10.8) |
| **Total Group revenue and operating profit** | **1,808.5** | 1,810.8 | **48.6** | 45.6 |
| Net finance expense | | | **(5.5)** | (6.7) |
| **Profit before taxation** | | | **43.1** | 38.9 |

1 Restatement in respect of retirement benefit obligations, see Note 34.

The accounting policies of the reportable segments are the same as the Group's accounting policies described in Note 1.

### Information about major customers

Included in revenues arising from newspaper and magazine wholesaling are revenues of approximately £162.1m (2013: £164.5m) which arose from sales to the Group's largest customer. No other single customer contributed 10% or more of the Group's revenue in either 2014 or 2013.

### Segment assets and liabilities

| £m | Assets 2014 | Assets 2013 | Liabilities 2014 | Liabilities 2013 | Net assets/(liabilities) 2014 | Net assets/(liabilities) 2013 |
|---|---|---|---|---|---|---|
| Connect News & Media: News | **144.5** | 142.3 | **(261.1)** | (266.5) | **(116.6)** | (124.2) |
| Connect News & Media: Media | **18.8** | 16.0 | **(7.2)** | (7.3) | **11.6** | 8.7 |
| Connect Books | **79.8** | 75.7 | **(56.9)** | (54.6) | **22.9** | 21.1 |
| Connect Education and Care | **57.8** | 55.0 | **(17.8)** | (17.5) | **40.0** | 37.5 |
| **Consolidated assets/(liabilities)** | **300.9** | 289.0 | **(343.0)** | (345.9) | **(42.1)** | (56.9) |

### *Segment depreciation, amortisation and non-current asset additions*

| £m | Depreciation 2014 | Depreciation 2013 | Amortisation 2014 | Amortisation 2013 | Additions to non-current assets 2014 | Additions to non-current assets 2013 |
|---|---|---|---|---|---|---|
| Connect News & Media: News | **(4.0)** | (4.3) | **(1.4)** | (1.3) | **7.7** | 6.7 |
| Connect News & Media: Media | **(0.1)** | (0.1) | **(0.3)** | (0.3) | **–** | – |
| Connect Books | **(0.6)** | (0.4) | **(2.4)** | (2.2) | **2.5** | 5.6 |
| Connect Education and Care | **(0.5)** | (0.5) | **(1.7)** | (1.2) | **1.2** | 1.6 |
| **Consolidated total** | **(5.2)** | (5.3) | **(5.8)** | (5.0) | **11.4** | 13.9 |

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the accounts continued

**1. Accounting policies** continued
The WH Smith Pension Trust is closed to further accrual and given the LDI policy adopted by the Pension Trustee, the present value of the economic benefits of the IAS19 (revised) surplus in the pension scheme of £75.7m (2013: £53.2m) available on a reduction of future contributions is £nil (2013:£nil). The Group recognises an onerous liability for the future agreed deficit contributions, a liability of £17.3m (2013: £20.3m).

**(s) Employee Benefit Trust**
Smiths News Employee Benefit Trust
The shares held by the Smiths News Employee Benefit Trust are valued at the historical cost of the shares acquired. This value is deducted in arriving at shareholders' funds and presented as another reserve in line with IAS32 'Financial Instruments: Disclosure and Presentation'.

**(t) Share schemes**
Share-based payments
The Group operates several share-based payment schemes, the largest of which are the Sharesave Scheme, the Executive Share Option Plan, the Long-term Incentive Plan (LTIP) and the Deferred Bonus Plan. Details of these are provided in the Remuneration report.

Equity-settled share-based schemes and are measured at fair value at the date of grant. The fair value is expensed with a corresponding increase in equity on a straight-line basis over the period during which employees become unconditionally entitled to the options. The fair values are calculated using an appropriate option pricing model. The income statement charge is then adjusted to reflect expected and actual levels of vesting based on non-market performance related criteria.

Administrative expenses and distribution and marketing expenses include the cost of the share-based payment schemes.

**(u) Changes in accounting policies**
New Standards and Interpretations not yet applied
At the date of authorisation of these financial statements, the following Standards and Interpretations that are potentially relevant to the Group and which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):
- IFRS9 'Financial Instruments: Classification and measurement' – effective for accounting periods beginning on or after 1 January 2018. – IFRS10 'Consolidated Financial Statements'
- IFRS10, IFRS12 and IAS27 (amended) 'Investment Entities'
- IFRS11 'Joint Arrangements'
- IFRS12 'Disclosure of Interest in Other Entities'
- IAS19 (amended) 'Defined Benefit Plans: Employee Contributions'
- IAS27 (revised) 'Separate Financial Statements'
- IAS28 (revised) 'Investments in Associates and Joint Ventures'
- IAS32 (amended) 'Offsetting Financial Assets and Financial Liabilities'
- IAS32 (amended) 'Offsetting Financial Assets and Financial Liabilities'
- IAS39 (amended) 'Novation of Derivatives and Continuation of Hedge Accounting'

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group, except for IFRS9 'Financial Instruments', which will introduce a number of changes in the presentation of financial instruments.

New Standards and Interpretations applied for the first time.

IAS1 (revised) requires that items of Other comprehensive income that may in future be recycled to the Consolidated Income Statement are presented separately from those which will not. This presentational change has been made to the Consolidated Statement of Comprehensive Income in the current year.

The following Standards with an effective date of 1 January 2013 have been adopted without any significant impact on the amounts reported in these financial statements:
- IFRS7 (amended) 'Disclosures – Offsetting Financial Assets and Financial Liabilities'
- IFRS13 'Fair Value Measurement'
- IAS12 (amended) 'Deferred Tax: Recovery of Underlying Assets'

**1. Accounting policies** continued

Bank borrowings

Interest bearing bank loans and overdrafts are initially measured at fair value (being proceeds received, net of direct issue costs), and are subsequently measured at amortised cost, using the effective interest rate method. Finance charges, including premiums payable on settlement or redemptions and direct issue costs are accounted for on an accruals basis and taken to the income statement using the effective interest rate method and are added to the carrying value of the instrument to the extent that they are not settled in the period in which they arise.

Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments to reduce exposure to interest rate movements. The Group does not hold derivative financial instruments for speculative purposes.

Derivative financial instruments are initially recognised at fair value on the date a derivative is entered into and are subsequently remeasured at fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

Where a derivative financial instrument is designated as a cash flow hedging instrument, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. The ineffective part of any gain or loss is recognised immediately in the income statement. When the forecast transaction subsequently results in the recognition of a non-financial asset or liability the associated cumulative gain or loss is removed from equity and included in the initial cost of the non-financial asset or liability. When the forecast transaction subsequently results in the recognition of a financial asset or liability, the associated cumulative gain or loss that was recognised directly in equity is reclassified into the income statement in the same period during which the asset acquired or liability assumed affects the income statement. Changes in the fair value of derivative financial instruments, where they are not designated as hedging instruments, are recognised in the income statement as operating costs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the net income or expense for the year.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not clearly and closely related to those of host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the income statement.

Foreign currencies

*Financial statements of foreign operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and are translated at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated at an average rate for the period where this rate approximates to the foreign exchange rates ruling at the dates of the transactions.

*Net investment in foreign operations*

Exchange differences arising from this translation of foreign operations, and of related qualifying hedges are taken directly to equity. They are recycled into the income statement upon disposal.

*Foreign currency transactions*

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

**(q) Provisions**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date and if this amount is capable of being reliably estimated. If such an obligation is not capable of being reliably estimated, no provision is recognised and the item is disclosed as a contingent liability where material. Where the effect is material, the provision is determined by discounting the expected future cash flows.

**(r) Retirement benefit costs**

The Group operates a number of defined contribution schemes for the benefit of its employees. Payments to the Group's schemes are recognised as an expense in the income statement as incurred. The Group operates three defined benefit pension schemes. The two largest schemes The WH Smith Pension Trust and The Consortium Care Scheme are closed to further accrual. The charge to the Group of providing benefits for these two schemes is determined by the Projected Unit Credit Method, with actuarial calculations being carried out at the balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur in the Group statement of comprehensive income. The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation adjusted for unrecognised past service cost, reduced by the fair value of scheme assets.

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the accounts continued

**1. Accounting policies** continued

**(i) Capitalisation of internally generated development costs**

Expenditure on developed software is capitalised when the Group is able to demonstrate all of the following: the technical feasibility of the resulting asset; the ability (and intention) to complete the development and use it; how the asset will generate probable future economic benefits; and the ability to measure reliably the expenditure attributable to the asset during its development. Subsequently to initial recognition, internally generated intangible assets are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

**(j) Jointly controlled entities and associates**

The Group Accounts include the Group's share of the total recognised gains and losses in its joint controlled entities and associates on an equity accounted basis.

Investments in jointly controlled entities and associates are carried in the balance sheet at cost adjusted by post-acquisition changes in the Group's share of the net assets of the jointly controlled entities and associates, less any impairment losses. The carrying values of investments in jointly controlled entities and associates include acquired goodwill. Losses in a jointly controlled entity or associate in excess of the Group's interest in the jointly controlled entity or associate are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the jointly controlled entity or associate.

**(k) Property, plant and equipment**

Property, plant and equipment assets are stated at cost less accumulated depreciation and any recognised impairment losses. No depreciation has been charged on freehold land. Other assets are depreciated, to a residual value, on a straight-line over their estimated useful lives, as follows:
- Freehold and long-term leasehold properties – over 20 years
- Short-term leasehold properties – shorter of the lease period and the estimated remaining economic life
- Fixtures and fittings – 3 to 15 years
- Equipment – 5 to 12 years
- Computer equipment – up to 5 years
- Vehicles – up to 5 years

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease. All property, plant and equipment is reviewed for impairment in accordance with IAS36 'Impairment of Assets' when there are indications that the carrying value may not be recoverable.

**(l) Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Property, plant and equipment held under finance leases is capitalised in the balance sheet at the lower of the fair value or the present value of the minimum lease payments and is depreciated over its useful life. The capital elements of future obligations under leases are included as liabilities in the balance sheet. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of return on the remaining balance of the liability.

Rentals paid under operating leases are charged to income on a straight line basis over the lease term. The benefits of rent free periods and similar incentives are credited to the income statement on a straight-line basis over the full lease term.

**(m) Inventories**

Inventories comprise goods held for resale and are stated at the lower of cost or net realisable value. Inventories are valued using a weighted average cost method. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition.

**(n) Trade receivables**

Trade receivables do not carry any interest and are stated at their fair value. They are measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in the income statement when there is evidence that the asset is impaired.

**(o) Trade payables**

Trade payables are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

**(p) Treasury**

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued are recorded at the proceeds received, net of direct issue costs.

**1. Accounting policies** continued

Taxation judgments

The Group recognises provisions for uncertain tax positions in accordance with the recognition and measurement criteria of both IAS12 'Income Taxes' and IAS37 'Provisions, Contingent Liabilities and Contingent Assets'. Provisions for uncertain tax positions are recognised when the Group has a present obligation as a result of a past event in respect of known tax risks (both UK and overseas) and when it is more likely than not that an outflow of economic benefits will be required to settle those obligations. Provisions for uncertain tax positions are measured based upon management's best estimate of the economic outflow and are remeasured annually at each balance sheet date, which estimates inherently involve significant judgment.

**(d) Adjusted measures**

The Group uses certain measures for internal reporting purposes and employee incentive arrangements. The terms 'net debt', 'free cash flow', 'underlying profit', 'Adjusted EBITDA' and 'non-recurring and other items' are not defined terms under IFRS and may not be comparable with similar measures disclosed by other companies.

The following are the key non-IFRS measures identified by the Group:

Underlying profit

Profit before non-recurring and other items.

Non-recurring and other items

Non-recurring and other items are material items of income or expense and include certain Mergers & Acquisitions related costs, business restructuring costs and network re-organisation costs including those relating to strategy changes which are not normal operating costs of the underlying business. They are disclosed and described separately in the accounts where it is necessary to do so to provide further understanding of the financial performance of the Group.

Free cash flow

Free cash flow is calculated as Group underlying operating profit adjusted for depreciation, amortisation, movements in working capital, capital expenditure, net interest, tax and cash pension funding and excludes non-recurring items, dividends, new finance lease, share purchases and any acquisition related costs.

Adjusted EBITDA

Adjusted EBITDA is calculated as operating profit before depreciation, amortisation and non-recurring items.

In line with loan agreements adjusted EBITDA used for covenant calculations is calculated as operating profit before depreciation, amortisation, non-recurring items and share-based payments charge but after adjusting for the last 12 months of profits for any acquisitions or disposals made in the year.

Net debt

Net debt is calculated as total debt less cash and cash equivalents. Total debt includes loans and borrowings, overdrafts and obligations under finance leases.

**(e) Revenue**

Revenue from the sale of goods is recognised when goods are delivered and title has passed. Revenue represents the amounts receivable for goods and services provided in the normal course of business, net of discounts, returns, VAT and other sales related taxes.

**(f) Operating profit**

Operating profit is stated after charging non-recurring and other items of an exceptional nature and after the share of results of associates but before investment income and finance costs.

**(g) Taxation**

Income tax on the profit or loss for the year comprises current and deferred tax. Current tax is the expected tax payable based on the taxable profit for the year, using tax rates enacted, or substantively enacted at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is calculated using tax rates enacted or substantively enacted at the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which these temporary differences can be utilised.

**(h) Dividends**

Interim and final dividends are recorded in the financial statements in the period in which they are paid.

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the accounts continued

**1. Accounting policies** continued
Assets held under finance leases are amortised over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease. All intangible assets are reviewed for impairment in accordance with IAS36 'Impairment of Assets' when there are indications that the carrying value may not be recoverable.

### Restatement of IAS19 Revised – retirement benefit obligation
IAS19 (as revised in June 2011) 'Employee Benefits' has been adopted by the Group for the financial year commencing 1 September 2013. The interest cost and expected return on defined-benefit pension scheme assets used in the previous version of IAS19 are replaced with a 'net interest' amount, which is calculated by applying a discount rate to the net defined benefit liability or asset. Furthermore, IAS19 (revised) also introduces more extensive disclosures in the presentation of the defined benefit cost, including the separate disclosure of the scheme's administrative expenses.

IAS19 (revised) has been applied retrospectively in accordance with IAS8. The comparative income statement has been restated, the impact being to reduce profits by £2.4m for the year ended 31 August 2013, as shown in Note 34. The impact to underlying earnings per share of the above changes for the year ended 31 August 2013 is a reduction of 1.3p. The impact on underlying diluted earnings per share for the year ended 31 August 2013 is a reduction of 1.3p. As the Company has always recognised actuarial gains and losses immediately, there is no effect on the prior year defined benefit obligation and balance sheet disclosure. Additionally, there is no impact on the pension liability or net assets, cash flows (including tax payments) or covenants as a result of this change.

**(c) Estimates and judgments**
The preparation of accounts requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

The significant judgments made in the accounts for the year ended 31 August 2014 are:

### Retirement benefit obligation
The Group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS19 'Retirement Benefit Obligations'. The calculations include a number of judgments and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy, amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. Management make these judgments in consultation with an independent actuary. Details of the judgments made in calculating the transactions are disclosed in Note 6.

In order to substantially reduce the volatility in the underlying investment performance and reduce the risk of a significant increase in the obligation, the Smiths News defined benefit scheme Pension Trust Trustee has adopted a Liability Driven Investment policy. This is discussed in more detail in Note 6.

### Impairment of goodwill
Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units to which goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value. No impairment loss was recognised for any cash generating unit as the present value of the goodwill was greater than the carrying amount that was held on the balance sheet. However, an impairment of £0.5m was recognised for a customer relationship intangible assets with regard to the Blackwell contract. Details of the value in use calculation are provided in Note 11b.

### Revenue recognition
Revenue from the sale of goods is recognised when goods are delivered and title has passed. Revenue represents the amounts receivable for goods and services provided in the normal course of business, net of discounts, returns, VAT and other sales related taxes.

The recognition of revenue involves a number of judgments and estimations, including the level of future returns. The Group records a returns reserve against the sales and cost of sales on the supply of newspapers and magazines on a sale or return basis. The provision is calculated in accordance with historical experience.

### Valuation of acquired intangibles
The valuation of acquired intangibles requires an estimation of value based on discounted future cash flows. The cash flows modelled represent the stand alone business acquired and do not include any synergies that may be available to the Group. The discount rate used is specific to each class of asset and specific to each acquisition. The key judgments are future cash flows and the discount rate.

### Onerous property contracts
Property provisions require an estimate to be made of the net present value of the future costs of vacant and sublet properties. The calculation includes estimates of future cost involved, including management's estimate of the long-term letting potential of the properties. Potential liabilities could crystallise in respect of previous assignments of leases where the liability could revert to the Group if the lessee defaulted. Pursuant to the terms of the Demerger Agreement any such contingent liability in respect of assignment prior to the demerger which becomes an actual liability will be apportioned between Connect Group PLC and WH Smith PLC in the ratio 35:65 (provided that the actual liability of Connect Group PLC in any 12 month period does not exceed £5m). The exposure to leases is reviewed on a regular basis and provisions are made when management estimate that it is probable that economic outflow will result.

# Connect Group PLC (formerly Smiths News PLC)
# Notes to the accounts

**1. Accounting policies**
**(a) Basis of consolidation**
Connect Group PLC (the 'Company') is a company incorporated in the UK under Companies Act 2006. The Group accounts for the year ended 31 August 2014 comprise the Company and, its subsidiaries (together referred to as the 'Group') and the Group's interests in jointly controlled entities and associates. Subsidiary undertakings acquired during the period are included in the Group Accounts from the date of acquisition. All significant subsidiary accounts are made up to 31 August and are included in the Group Accounts. Further to the EU IAS Regulation (Article 4) the Group accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (adopted IFRS) with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The Company Accounts continue to be prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP) and details of the Company Accounts, Notes to the Accounts and principal accounting policies are set out below.

Unless otherwise noted references to 2014 and 2013 relate to fiscal year ended 31 August 2013 and 31 August 2014 as opposed to calendar year.

The accounts were authorised for issue by the directors on 15 October 2014.

**(b) Basis of preparation**
Accounting basis of preparation
The accounts are prepared on the historical cost basis except certain financial instruments detailed below and are presented in Pound Sterling and rounded to £0.1m, except where otherwise indicated. This document may contain some immaterial rounding differences in the tables.

The Group Accounts have been prepared in accordance with IFRS as adopted for use by the European Union.

Intra-group balances and unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing Group Accounts. Unrealised gains arising from transactions with the jointly controlled entities are eliminated to the extent of the Group's interest in the entities. Unrealised losses are eliminated in the same way as unrealised gains.

Going concern and net liabilities
As detailed in Note 20, at the year end the Group had committed bank facilities in place of £200m, with associated covenants. The Group's forecasts and projections, taking account of reasonable potential variations in trading performance and the Group's negative working capital position, show that the Group should be able to operate within the level of its current financing covenants for the foreseeable future.

Despite the uncertain economic environment the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus the Group continues to adopt the going concern basis in preparing its consolidated financial statements.

Business combinations and goodwill
The Group uses the acquisition method of accounting to account for business combinations. The cost of an acquisition is measured at the fair value of the assets given, equity instruments issued, liabilities incurred or assumed at the date of exchange. Acquisition related costs are recognised in profit or loss as incurred. Any deferred or contingent purchase consideration is recognised at fair value over the period of entitlement. If the contingent purchase consideration is classified as equity, it is not remeasured and settlement is accounted for in equity. Any deferred or contingent payment deemed to be remuneration as opposed to purchase consideration in nature is recognised in profit or loss as incurred, and excluded from the acquisition method of accounting for business combinations. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured, initially, at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest. The non-controlling interest is measured, initially, at the non-controlling interest's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

Goodwill arising on all acquisitions is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

The carrying value is reviewed annually for impairment or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets arising under a business combination (acquired intangibles) are capitalised at fair value as determined at the date of exchange and are stated at fair value less accumulated amortisation and impairment losses. Amortisation of acquired intangibles is charged to the income statement on a straight-line basis over the estimated useful lives as follows:
- Customer relationships – 2.5 to 7.5 years
- Trade name – 5 to 7.5 years
- Software and development costs – 3 to 7 years

In the current year the estimated useful lives for customer relationships and trade names have been reduced from a maximum of ten years to a maximum of 7.5 years based upon an assessment of future contractual renewal rates.

Computer software and internally generated development costs which are not integral to the related hardware are capitalised separately as an intangible asset and stated at cost less accumulated amortisation and impairment losses.

# Connect Group PLC (formerly Smiths News PLC)
# Group cash flow statement
## for the year ended 31 August 2014

| £m | Note | 2014 | 2013 |
|---|---|---|---|
| **Net cash inflow from operating activities** | 27 | **47.4** | 37.9 |
| **Investing activities** | | | |
| Dividends received from associates | | **0.2** | – |
| Acquisitions | 12 | **(0.3)** | (5.1) |
| Purchase of property, plant and equipment | | **(6.8)** | (5.0) |
| Purchase of intangible assets | | **(3.5)** | (2.8) |
| **Net cash used in investing activities** | | **(10.4)** | (12.9) |
| **Financing activities** | | | |
| Interest paid | | **(6.1)** | (4.0) |
| Dividend paid | | **(17.7)** | (16.0) |
| Repayments of obligations under finance leases | | **(1.3)** | (2.0) |
| Proceeds on issue of shares | | **0.7** | 0.7 |
| Purchase of shares for Employee Benefit Trust | | **(6.3)** | (2.3) |
| Repayments of borrowings | | **(34.0)** | – |
| New bank loans raised | | **50.0** | – |
| Increase/(decrease) in borrowings | | **(11.9)** | 3.7 |
| **Net cash (used in)/from financing activities** | | **(26.6)** | (19.9) |
| | | | |
| **Net increase in cash and cash equivalents** | | **10.4** | 5.1 |
| Effect of foreign exchange rate changes | | **(0.1)** | (0.1) |
| | | **10.3** | 5.0 |
| Opening net cash and cash equivalents | | **10.1** | 5.1 |
| **Closing net cash and cash equivalents** | 19 | **20.4** | 10.1 |

| **Analysis of net debt** | | | |
|---|---|---|---|
| Cash and cash equivalents | 19 | **20.4** | 10.1 |
| Current borrowings | 19 | **(60.9)** | (72.8) |
| Non-current borrowings | 19 | **(48.4)** | (34.0) |
| **Net borrowings** | | **(88.9)** | (96.7) |
| Finance lease liabilities | 21 | **(4.1)** | (1.8) |
| **Net debt** | | **(93.0)** | (98.5) |

# Connect Group PLC (formerly Smiths News PLC)
# Group statement of changes in equity
## for the year ended 31 August 2014

| £m | Share capital | Share premium account | Demerger reserve | ESOP reserve | Hedging & translation reserve | Retained earnings | Non-controlling interests in equity | Total |
|---|---|---|---|---|---|---|---|---|
| Balance at 31 August 2012 – reported | 9.2 | 0.6 | (280.1) | (1.7) | (2.3) | 196.7 | – | (77.6) |
| Profit for the year | – | – | – | – | – | 28.7 | – | 28.7 |
| Gain on cash flow hedges | – | – | – | – | 1.7 | – | – | 1.7 |
| Actuarial gain on defined benefit pension scheme | – | – | – | – | – | 4.3 | – | 4.3 |
| Impact of IFRIC 14 on defined benefit pension scheme | – | – | – | – | – | 3.4 | – | 3.4 |
| Tax relating to components of other comprehensive income | – | – | – | – | – | (2.5) | – | (2.5) |
| **Total comprehensive income for the year – Restated[1]** | – | – | – | – | 1.7 | 33.9 | – | 35.6 |
| Issue of share capital | – | 0.6 | – | – | – | – | – | 0.6 |
| Dividends paid | – | – | – | – | – | (16.0) | – | (16.0) |
| Employee share schemes | – | – | – | 0.2 | – | (0.2) | – | – |
| Recognition of share-based payments | – | – | – | – | – | 0.5 | – | 0.5 |
| **Balance at 31 August 2013 – Restated[1]** | 9.2 | 1.2 | (280.1) | (1.5) | (0.6) | 214.9 | – | (56.9) |
| Profit for the year | – | – | – | – | – | 34.6 | 0.2 | 34.8 |
| Gain on cash flow hedges | – | – | – | – | 0.6 | – | – | 0.6 |
| Actuarial gain on defined benefit pension scheme | – | – | – | – | – | 14.8 | – | 14.8 |
| Impact of IFRIC 14 on defined benefit pension scheme | – | – | – | – | – | (16.2) | – | (16.2) |
| Currency translation differences | – | – | – | – | (0.2) | – | – | (0.2) |
| Tax relating to components of other comprehensive income | – | – | – | – | (0.1) | 0.1 | – | – |
| **Total comprehensive income for the year** | – | – | – | – | 0.3 | 33.3 | 0.2 | 33.8 |
| Issue of share capital | 0.3 | 4.1 | – | – | – | – | – | 4.4 |
| Purchase of own shares | – | – | – | (6.3) | – | – | | (6.3) |
| Dividends paid | – | – | – | – | – | (17.7) | – | (17.7) |
| Employee share schemes | – | – | – | 2.6 | – | (2.6) | – | – |
| Recognition of share-based payments net of tax | – | – | – | – | – | 0.6 | – | 0.6 |
| **Balance at 31 August 2014** | **9.5** | **5.3** | **(280.1)** | **(5.2)** | **(0.3)** | **228.5** | **0.2** | **(42.1)** |

1 Restatement in respect of retirement benefit obligations, see Note 34.

# Connect Group PLC (formerly Smiths News PLC)
# Group balance sheet
## at 31 August 2014

| £m | Note | 2014 | 2013 |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 11a | **65.7** | 68.2 |
| Property, plant and equipment | 14 | **29.0** | 26.6 |
| Interest in jointly controlled entities and associates | 15 | **4.3** | 4.1 |
| Derivative financial instruments | 20 | **0.6** | 0.4 |
| Retirement benefit assets | 6 | **0.3** | 0.2 |
| Deferred tax assets | 23 | **7.2** | 8.1 |
| | | **107.1** | 107.6 |
| **Current assets** | | | |
| Inventories | 16 | **45.3** | 44.2 |
| Trade and other receivables | 17 | **128.1** | 127.1 |
| Cash and cash equivalents | 19 | **20.4** | 10.1 |
| | | **193.8** | 181.4 |
| **Total assets** | | **300.9** | 289.0 |
| **Current liabilities** | | | |
| Trade and other payables | 18 | **(192.3)** | (188.7) |
| Current tax liabilities | | **(6.1)** | (8.1) |
| Bank loans and other borrowings | 19 | **(60.9)** | (72.8) |
| Obligations under finance leases | 21 | **(0.9)** | (1.0) |
| Derivative financial instruments | 20 | **–** | (0.8) |
| Retirement benefit obligations | 6 | **(4.1)** | (4.1) |
| Provisions | 24 | **(3.4)** | (7.5) |
| | | **(267.7)** | (283.0) |
| **Non-current liabilities** | | | |
| Retirement benefit obligations | 6 | **(17.2)** | (19.2) |
| Bank loans and other borrowings | 19 | **(48.4)** | (34.0) |
| Obligations under finance leases | 21 | **(3.2)** | (0.8) |
| Other non-current liabilities | 22 | **(1.4)** | (1.6) |
| Deferred tax liabilities | 23 | **(3.2)** | (4.5) |
| Non-current provisions | 24 | **(1.9)** | (2.8) |
| | | **(75.3)** | (62.9) |
| **Total liabilities** | | **(343.0)** | (345.9) |
| **Total net liabilities** | | **(42.1)** | (56.9) |
| **Equity** | | | |
| Called up share capital | 28(a) | **9.5** | 9.2 |
| Share premium account | 28(c) | **5.3** | 1.2 |
| Demerger reserve | 29(a) | **(280.1)** | (280.1) |
| ESOP reserve | 29(b) | **(5.2)** | (1.5) |
| Hedging & translation reserve | 29(c) | **(0.3)** | (0.6) |
| Retained earnings | 30 | **228.5** | 214.9 |
| **Total shareholders equity** | | **(42.3)** | (56.9) |
| Non- controlling interests in equity | | **0.2** | – |
| **Total equity** | | **(42.1)** | (56.9) |

The accounts were approved by the Board of Directors and authorised for issue on 15 October 2014 and were signed on its behalf by:

Registered number – 05195191

**Mark Cashmore**
**Group Chief Executive**

**Nick Gresham**
**Chief Financial Officer**

# Connect Group PLC (formerly Smiths News PLC)
# Group income statement
for the year ended 31 August 2014

| £m | Note | 2014 Underlying[1] | 2014 Non-recurring and other items | 2014 Total | 2013 Restated[2] Underlying[1] | 2013 Restated[2] Non-recurring and other items | 2013 Restated[2] Total |
|---|---|---|---|---|---|---|---|
| **Continuing operations** | | | | | | | |
| Revenue | 2 | **1,808.5** | **–** | **1,808.5** | 1,806.9 | 3.9 | 1,810.8 |
| **Operating profit** | 2,3 | **55.5** | **(6.9)** | **48.6** | 56.4 | (10.8) | 45.6 |
| Investment revenue | 7 | **0.4** | **–** | **0.4** | 0.3 | – | 0.3 |
| Finance costs | 7 | **(5.9)** | **–** | **(5.9)** | (6.8) | (0.2) | (7.0) |
| **Profit before tax** | | **50.0** | **(6.9)** | **43.1** | 49.9 | (11.0) | 38.9 |
| Income tax expense | 8 | **(9.3)** | **1.0** | **(8.3)** | (11.5) | 1.3 | (10.2) |
| **Profit for the year** | | **40.7** | **(5.9)** | **34.8** | 38.4 | (9.7) | 28.7 |
| | | | | | | | |
| **Profit attributable to equity shareholders** | | **40.5** | **(5.9)** | **34.6** | 38.4 | (9.7) | 28.7 |
| **Profit attributable to non-controlling interest** | | **0.2** | **–** | **0.2** | – | – | – |
| | | **40.7** | **(5.9)** | **34.8** | 38.4 | (9.7) | 28.7 |

| £m | Note | 2014 Underlying[1] | 2014 Non-recurring and other items | 2014 Total | 2013 Restated[2] Underlying[1] | 2013 Restated[2] Non-recurring and other items | 2013 Restated[2] Total |
|---|---|---|---|---|---|---|---|
| **Earnings per share** | | | | | | | |
| Basic | 10 | **21.7p** | | **18.6p** | 21.1p | | 15.7p |
| Diluted | 10 | **21.0p** | | **18.0p** | 19.8p | | 14.8p |
| | | | | | | | |
| Equity dividends per share (paid and proposed) | 9 | | | **9.7p** | | | 9.3p |

1 Before non-recurring and other items. Non-recurring and other items are set out in Note 4 to the accounts. These measures are described in Note 1d of the accounting policies.
2 *Restatement in respect of retirement benefit obligations and disposal of MMC business, see Note 34.*

# Connect Group PLC (formerly Smiths News PLC)
# Group statement of comprehensive income
for the year ended 31 August 2014

| £m | Note | 2014 | 2013 Restated[1] |
|---|---|---|---|
| **Items that will not be reclassified to the Group Income Statement** | | | |
| Actuarial gain on defined benefit pension scheme | 6 | **14.8** | 4.3 |
| Impact of IFRIC 14 on defined benefit pension scheme | 6 | **(16.2)** | 3.4 |
| Tax relating to components of other comprehensive income that will not be reclassified | 8 | **0.1** | (2.7) |
| | | **(1.3)** | 5.0 |
| **Items that may be reclassified to the Group Income Statement** | | | |
| Gain on cash flow hedges | 29 | **0.6** | 1.7 |
| Currency translation differences | | **(0.2)** | – |
| Tax relating to components of other comprehensive income that may be reclassified | 8 | **(0.1)** | 0.2 |
| | | **0.3** | 1.9 |
| **Other comprehensive income for the year** | | **(1.0)** | 6.9 |
| Profit for the year | | **34.8** | 28.7 |
| **Total comprehensive income for the year** | | **33.8** | 35.6 |
| Total comprehensive income attributable to equity shareholders | | **33.6** | 35.6 |
| Total comprehensive income attributable to non-controlling interest | | **0.2** | – |

1 Restatement in respect of retirement benefit obligations and disposal of MMC business, see Note 34.

# Independent auditor's report to the members of Connect Group PLC (formerly Smiths News PLC) continued

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The Group audit team continued to follow a programme of planned visits that has been designed so that the Senior Statutory Auditor or a senior member of the Group audit team visits each component at least once a year.

**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; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Matters on which we are required to report by exception**
**Adequacy of explanations received and accounting records**
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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 are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

**Directors' remuneration**
Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

**Corporate Governance Statement**
Under the Listing Rules we are also required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

**Our duty to read other information in the Annual Report**
Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

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

In particular, we are required to 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 we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

**Respective responsibilities of directors and auditor**
As explained more fully in the Directors' Responsibilities Statement, 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. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team, strategically focused second partner reviews and independent partner reviews.

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.

**Scope of the audit of the financial statements**
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Alexander Butterworth ACA (Senior statutory auditor)**
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Reading, United Kingdom
15 October 2014

| Risk | How the scope of our audit responded to the risk |
|---|---|
| **Defined Benefit Pension Schemes**<br>The determination of the value of the retirement benefit obligations (which at 31 August 2014 for the Pension Trust Scheme stood at £431.6m) requires significant judgement in the selection of key assumptions and is highly sensitive to such assumptions. Management made significant judgements in respect of mortality, price inflation and discount rates in deriving the value of the retirement benefit obligations.<br><br>In addition on the Pension Trust scheme there are two further main aspects. Firstly, given the surplus position on the scheme on an IAS19 basis, there is a judgement taken whereby this surplus of £75.7m at 31 August 2014 is not available for use by the Group, and therefore it is restricted to nil.<br><br>Secondly, due to there also being a schedule of contributions in place to fund the Pension Trust scheme, separate to the surplus above, there is a requirement under IFRIC14 to recognise a liability in respect of this funding commitment.<br><br>This is discussed within management's key sources of judgement and estimation uncertainty within Note 1. | We used our internal actuarial experts to assist us in assessing the assumptions applied in determining the pension obligations, particularly given recent market volatility, and determined whether the key assumptions were reasonable. This included benchmarking the assumptions in respect of the discount rate, inflation and mortality assumptions to those used in the market, and reviewing available yield curves and inflation data to recalculate a reasonable range for the key assumptions.<br><br>We challenged management to understand the sensitivity of changes in assumptions and quantify a range of reasonable rates that could be used in their calculation. Further, we discussed the output of sensitivity analysis with management and the third party actuarial advisers.<br><br>Specifically for the Pension Trust scheme we have reviewed the agreements with the pension trustees to identify the availability of any funding surplus to the Group, and in addition, confirmed the schedule of contributions, which is recognised in accordance with IFRIC 14 as a liability on the balance sheet. |
| **Revenue Recognition**<br>Revenue recognition represents a risk due to the high volume of revenue transactions that exist through the year, and the sale or return basis on which the News business operates. As a result therefore the risk is focused on cut-off at the year-end date.<br><br>This requires significant management judgement to determine the level of returns anticipated at the end of the year, and therefore appropriate cut-off of revenue.<br><br>This is discussed within management's key sources of judgement and estimation uncertainty within Note 1. | We use internal IT specialists to assist us in providing assurance over the automation of controls within the revenue cycle.<br><br>In addition we use external industry data to evaluate the sales trends within the business, to identify any anomalies or unusual transactions which could impact on the cut-off of revenue.<br><br>In respect of goods sold on a sale or return basis, we evaluate management's judgement with regards to the level of sale returns through the use of historical return data and evidence of actual returns post year-end. |
| **Inventory Provisioning**<br>Assessing net realisable value is an area of significant judgement, with specific consideration in relation to the estimate of provision for slow-moving and obsolete stock.<br><br>This is further heightened in the year with the decline in performance within the Books division.<br><br>This is discussed within management's key sources of judgement and estimation uncertainty within Note 1. | For all divisions including the Books division we have assessed the appropriateness of the inventory provision by initially understanding the methodology and then challenging management on this methodology in reference to historical accuracy of the provision against actual losses.<br><br>We assessed the accuracy of the application of the provisioning methodology by recalculation, assessing the assumptions made to provisioned inventory lines to check that the provision percentage applied is appropriate and in line with the documented provisioning policy. We have also considered the ageing of inventory compared with applicable returns periods to identify any non-returnable inventory.<br><br>We also attended inventory counts at the major warehouses to independently verify inventory existence and any indicators of obsolescence. |

The Audit Committee's consideration of these risks is set out on page 37.

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 accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

**Our application of materiality**

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the group to be £2.2m, which equates to 5% of statutory profit before tax.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £44,500, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

**An overview of the scope of our audit**

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we focused our Group audit scope primarily on the audit work at five components. All five of these components were subject to a full audit. These five components represent the principal business units and account for 99% of the Group's net liabilities, 96% of the Group's revenue and 97% of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above. Our audit work at the five components was executed at levels of materiality applicable to each individual entity which were lower than Group materiality.

# Other statutory disclosures continued

**Greenhouse gas emissions**
Details of the Group's greenhouse gas emissions are set out in the Corporate Responsibility report on page 24.

**Political donations**
It is the Group's policy not to make political donations and no political donations or EU political expenditure were made in the year (2012: £nil).

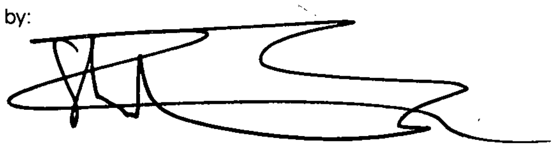
**Financial instruments**
Information on the Group's financial risk management objectives and policies and on the exposure of the Group to relevant risks in respect of financial instruments is set out in Note 20 to the Accounts.

**Disclosure of information to auditor**
Each director confirms that, so far as he is aware, there is no relevant audit information (as defined in section 418 of the Companies Act 2006) of which the Company's auditor is unaware and that each director has taken all the steps he ought reasonably to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

**Auditor**
Resolutions to reappoint Deloitte LLP as auditor of the Company and to authorise the Audit Committee to determine their remuneration will be proposed at the Annual General Meeting.

**Annual General Meeting**
The Annual General Meeting of the Company will be held at Rowan House, Cherry Orchard North, Kembrey Park, Swindon, Wiltshire SN2 8UH on 4 February 2015 at 11.30am. The Notice of Annual General Meeting is given, together with explanatory notes on the five items of special business to be considered at the meeting, in the booklet which accompanies this report.

Approved by the Board and signed on its behalf by:



**Stuart Marriner**
Company Secretary & General Counsel
15 October 2014

There are no other restrictions on the transfer of ordinary shares in the Company other than those imposed by prevailing laws and regulations (such as insider trading laws and market requirements in respect of close periods).

The Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of ordinary shares or on voting rights.

**Shares held by the Employee Benefit Trust**
The Trustee of the Smiths News Employee Benefit Trust holds ordinary shares of the Company on behalf of the beneficiaries of the Trust, who are the employees and former employees of the Group. If any offer is made to the holders of ordinary shares to acquire their shares, the Trustee will not be obliged to accept or reject the offer in respect of any shares which are at that time subject to subsisting options, but will have regard to the interests of the option holders and can consult them to obtain their views on the offer, and subject to the foregoing, the Trustee will take the action with respect to the offer it thinks fair. The Trustee waives its right to vote and to dividends on the shares that it holds. Further details on the Trust can be found in the Directors' remuneration report on page 55.

**Purchase of own shares**
At the Annual General Meeting held on 23 January 2014, authority was given for the Company to purchase, in the market, up to 18,442,799 ordinary shares of 5p each. The Company did not use this authority to make any purchases of its own shares during the financial year. This authority is renewable annually and approval will be sought from shareholders at the Annual General Meeting in 2015 to renew the authority for a further year.

**Issue of new ordinary shares**
During the financial year ended 31 August 2014, 4,959,905 ordinary shares in the Company were issued, of which 4,530,012 relate to the deferred share capital payable to the former owners of Hedgelane Ltd following its acquisition in April 2012, and 429,893 were under the Sharesave Scheme at prices between 78.6p and 140.0p. The Articles provide that the Board may, subject to the prior approval of the Company's shareholders, exercise all the powers of the Company to allot relevant securities including new ordinary shares.

**Interests in voting rights**
As at 31 August 2014, the Company had been notified, pursuant to the Financial Conduct Authority's Disclosure and Transparency Rule 5, of the following notifiable interests in its issued share capital:

| Holder | Number | % of Voting Rights | Nature of Holding |
|---|---|---|---|
| Silchester International Investors LLP | 18,332,319 | 9.94 | Indirect Interest |
| Prudential plc | 18,080,038 | 9.85 | Direct Interest |
| Henderson Global Investors | 15,522,275 | 8.46 | Indirect Interest |
| Ameriprise Financial, Inc. | 10,012,566 | 5.44 | Indirect Interest |
| Aberforth Partners LLP | 10,051,763 | 5.32 | Indirect Interest |
| Hargreave Hale Limited | 9,656,422 | 5.11 | Indirect Interest |

There have been no changes in the period 1 September 2014 to 15 October 2014.

Except for the above, the Company is not aware of any ordinary shareholders with interests in 3% or more of the voting rights attached to the issued share capital of the Company.

**Significant agreements – change of control**
Each of the Company's trading subsidiaries has agreements with customers and suppliers that contain change of control clauses giving rights to those customers and suppliers on a takeover of the Company.

A change of control of the Company following a takeover bid may cause a number of other agreements to which the Company and/or one or more of its subsidiaries is party, such as banking arrangements, property leases and licence agreements to alter or be capable of termination at the election of the counterparty.

The Company does not have agreements with any director or employee that would provide compensation for loss of office or employment resulting from a takeover except that provisions of the Company's share schemes may cause options and awards granted to employees under such schemes to vest on a takeover.

**Directors**
The directors are responsible for the management of the business of the Company and may exercise all the powers of the Company subject to applicable legislation and regulation and the Company's Articles.

The Company's Articles give power to the Board to appoint directors and (where notice is given signed by all the other directors) remove a director from office. They also give a power to the Company to appoint directors (by ordinary resolution) and remove a director from office (by special resolution or by ordinary resolution of which special notice has been given).

The interests of the directors and their immediate families in the share capital of the Company, along with details of directors' share options and awards, are set out in the Directors' remuneration report on pages 53 and 54.

At no time during the year did any of the directors have a material interest in any significant contract with the Company or any of its subsidiaries.

The Company maintains directors' and officers' liability insurance which gives appropriate cover for any legal action brought against its directors. The Company has also provided an indemnity for its directors and secretary and for the directors of its Associated Companies, to the extent permitted by law, which is a qualifying third party indemnity provision for the purposes of section 234 of the Companies Act 2006.

**Employees**
Details of the Group's policies in relation to employment, training and development, employee engagement, employee share ownership and equal opportunities are set out in the Corporate Responsibility report on pages 24 to 27.

# Other statutory disclosures

### Directors' report
This Annual Report and Accounts includes the Directors' report and the audited accounts of Connect Group PLC (the Company) and its subsidiaries (the Group) for the year ended 31 August 2014. The information required to be disclosed in the Directors' report is provided in the following sections of the Annual Report and Accounts, which are incorporated into the Directors' report by reference:
- Strategic report on pages 1 to 27;
- Corporate Governance on pages 28 to 35;
- Audit Committee report on pages 36 to 38;
- Nominations Committee report on pages 39 to 40;
- Directors' remuneration report on pages 41 to 57;
- this section, Other statutory disclosures;
- Directors' responsibilities statement on page 61; and
- Notes to the Accounts as detailed in this section.

### Strategic report
The Strategic report, including a review of the business of the Group during the financial year ended 31 August 2014 and a description of the Group's strategy, business model and principal risks and uncertainties is set out on pages 1 to 27 of the Annual Report and Accounts.

By their nature, the statements concerning the risks and uncertainties facing the Group involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this Annual Report and Accounts and the Company undertakes no obligation to update these forward-looking statements. Nothing in this Annual Report and Accounts should be construed as a profit forecast.

Both the Strategic report and the Directors' report have been drawn up and presented in accordance with, and in reliance upon applicable English company law, and the liabilities of the directors in connection with those reports shall be subject to the limitations and restrictions provided by such law.

The Company's principal operating subsidiaries and associated undertakings are listed in Note 33 to the Accounts.

### Post balance sheet events
There were no post balance sheet events.

### Profit and dividends
The profit for the financial year, after taxation, was £34.8m (2013: £28.7m).

The directors recommend the payment of a final dividend for the year of 6.6p per ordinary share (2013: 6.3p) on 6 February 2015 to members on the Register at the close of business on 9 January 2015.

This final dividend, together with the interim dividend of 3.1p per ordinary share paid on 11 July 2014, makes a total dividend of 9.7p per ordinary share for the year ended 31 August 2014 (2013: 9.3p).

### Share capital
The Company's issued share capital comprises a single class of ordinary shares of 5p each. All issued shares are fully paid, can be held in certificated or uncertificated form and are listed on the London Stock Exchange. Details of movements in the issued share capital during the year can be found in Note 28 to the Accounts.

The rights and obligations attaching to the Company's ordinary shares, in addition to those conferred on their holders by law, are set out in the Company's Articles of Association (the 'Articles'), a copy of which can be obtained from Companies House or from the Company's website www.connectgroupplc.com. The Company's Articles may only be amended by a special resolution of the Company. Subject to applicable statutes, shares may be issued with such rights and restrictions as the Company may by ordinary resolution decide, or (if there is no such resolution or so far as it does not make specific provision) as the Board may decide.

Holders of ordinary shares are entitled to: attend and speak at general meetings of the Company; to appoint one or more proxies and, if they are corporations, to appoint corporate representatives; and to exercise voting rights. Holders of ordinary shares may also receive a dividend and on a liquidation may share in the assets of the Company. In addition, holders of ordinary shares are entitled to receive the Company's Annual Report and Accounts. Subject to meeting certain thresholds, holders of ordinary shares may require a general meeting of the Company to be held or propose resolutions to be considered at Annual General Meetings.

### Voting rights and restrictions on transfer of shares
On a show of hands at a general meeting of the Company, every holder of ordinary shares present in person or by proxy and entitled to vote has one vote and on a poll every member present in person or by proxy and entitled to vote has one vote for every ordinary share held. None of the ordinary shares carry any special rights with regard to control of the Company. Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrars not later than 48 hours before a general meeting. However, when calculating the 48 hour period, no account is taken of any part of a day that is not a working day.

The directors may refuse to register a transfer of a certificated share: which is not fully paid, provided that the refusal does not prevent dealings in the shares in the Company from taking place on an open and proper basis; or on which the Company has a lien. The directors may also refuse to register a transfer of a certificated share unless the instrument of transfer: (i) is lodged at the office, or such other place as the directors may decide accompanied by the certificate for the share to which it relates and such other evidence (if any) as the directors may reasonably require to show the right of the transferor to make the transfer; (ii) is in respect of only one class of shares; and (iii) is in favour of not more than four transferees.

Transfers of uncertificated shares must be carried out using CREST and the directors can refuse to register a transfer of an uncertificated share in accordance with the regulations governing the operation of CREST.

**Letters of appointment**

All non-executive directors, including the Chairman, have a letter of appointment for an initial three-year term, which can be terminated by either party giving three months' notice, as set out in the table below.

| | Date of original appointment | Date of current appointment | Notice period/unexpired term |
|---|---|---|---|
| Dennis Millard | 31 August 2006 | 6 February 2008 | 3 months/3 months |
| Andrew Brent | 1 September 2008 | 1 September 2008 | 3 months/3 months |
| Anthony Cann | 31 August 2006 | 31 August 2006 | 3 months/3 months |
| John Worby | 31 August 2006 | 31 August 2006 | 3 months/3 months |

**Remuneration Committee**

The Remuneration Committee is chaired by Anthony Cann and its other members throughout the year were Andrew Brent, Dennis Millard and John Worby. Anthony Cann, Andrew Brent and John Worby are all independent non-executive directors and Dennis Millard was independent on appointment as Chairman. The Committee met four times during the year and each meeting was attended by all Committee members.

The Committee's terms of reference, which are available on the Company's website and from the Company Secretary on request, set out the responsibilities of the Committee which include:

- determining and agreeing with the Board the broad policy for the remuneration of the Chairman, executive directors and certain other senior executives;
- reviewing the ongoing appropriateness and relevance of the remuneration policy;
- reviewing the policy for any performance related pay schemes operated for those below executive management level and approving total annual payments made under all performance related pay schemes;
- reviewing the design of all short and long-term incentive plans for approval by the Board and, where required, by shareholders;
- determining the policy for the grant of share incentives to executive directors and senior executives, setting appropriate performance targets and approving the quantum of grants and vesting schedules;
- ensuring that contractual terms on termination, and any payments made, are fair to the individual and the Company, that failure is not rewarded and that the duty to mitigate loss is fully recognised;
- determining the remuneration of the Chairman; and
- determining the total individual remuneration package of each executive director and other senior executives including bonuses and share incentives.

During the year the Committee received external advice and services from its independent adviser, Deloitte LLP (Deloitte). Deloitte also provided audit services to the Company. The Committee is satisfied that Deloitte has adequate safeguards in place, including separate engagement teams led by separate engagement partners, to ensure that its independence is not impaired. Furthermore, Deloitte is a member of the Remuneration Consultants' Group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The code of conduct can be found at www.remunerationconsultantsgroup.com. Deloitte's fees for advice provided to the Remuneration Committee in the financial year were £29,000, and were charged on a time and materials basis. The Committee is mindful of the length of tenure of Deloitte as remuneration advisers and the fact that Deloitte are also the Company's auditors and intends to conduct a review of remuneration services in the next 12 months.

Sarah Miles, Group Human Resources Director, also materially assisted the Committee in carrying out its duties, except in relation to her own remuneration.

**Shareholder consultation**

The Committee welcomes dialogue with shareholders on executive remuneration, and consulted with major shareholders and investor representative bodies prior to implementing a number of changes to the remuneration policy in 2012/13.

**Shareholder voting at the AGM**

At the Annual General Meeting held on 23 January 2014, 92.90% of shareholders voted in favour of approving the directors' remuneration report for 2012/13. Details of the votes cast are as follows:

| For (inc. discretionary) | | Against | | Total | Withheld |
|---|---|---|---|---|---|
| Number | % | Number | % | Number | Number |
| 107,538,074 | 92.90 | 8,220,966 | 7.10 | 115,759,040 | 11,170,429 |

**Approval**

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

**Anthony Cann**

Chairman of the Remuneration Committee

15 October 2014

# Directors' remuneration report continued

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

The table below shows the percentage change in the Group Chief Executive's total remuneration (excluding the value of any EPP, LTIP and pension benefits) between the financial year ended 31 August 2013 and 31 August 2014, compared to that of all UK-based employees. This group has been chosen as the majority of our workforce is UK-based.

| | % change FY2013 – FY2014 | | |
|---|---|---|---|
| | Base salary | Benefits | Annual Bonus |
| Group Chief Executive | 10.9 | 4.4 | -79.9 |
| UK employees | 5.8 | 9.1 | -15.2 |

### Relative importance of spend on pay

In line with the new regulations, the table below illustrates the Company's expenditure on pay in comparison to profits before tax, corporation tax paid and distributions to shareholders by way of dividend payments.

| | 2012/13 £m | **2013/14 £m** | % change |
|---|---|---|---|
| Total employee pay | 92.7 | **93.4** | 0.8 |
| Underlying Group profit before tax | 49.9 | **50.0** | 0.2 |
| Income tax paid | 10.5 | **9.8** | -6.7 |
| Dividends paid | 16.0 | **17.7** | 10.6 |

The figures above are as set out in the Group income statement on page 65 and on pages 78, 83 and 94 in the Notes to the Accounts. Total employee pay is the total pay for all Group employees. Underlying Group profit before tax has been used as a comparison as this is the key financial metric which the Board considers when assessing Company performance.

### Non-executive directors

As detailed in the remuneration policy on page 47, non-executive directors receive fees reflective of the time commitment, demands and responsibilities of the role. There were no changes to the fees paid to non-executive directors during the year under review.

### Non-executive directors' 'single figure' of remuneration for 2013/14 and 2012/13 (audited)

| | Year | Basic fees[a] £'000 | Additional fees £'000 | **Total £'000** |
|---|---|---|---|---|
| Dennis Millard | 2013/14 | 110 | – | **110** |
| | 2012/13 | 110 | – | **110** |
| Andrew Brent | 2013/14 | 35 | – | **35** |
| | 2012/13 | 35 | – | **35** |
| Anthony Cann | 2013/14 | 35 | 5 | **40** |
| | 2012/13 | 35 | 5 | **40** |
| John Worby | 2013/14 | 35 | 5 | **40** |
| | 2012/13 | 35 | 5 | **40** |

(a) Dennis Millard is paid a single fee which includes chairmanship of the Nominations Committee.
(b) All of the non-executive directors served throughout the year.

### Non-executive directors' shareholdings (audited)

The beneficial interests of the non-executive directors and their immediate families in the ordinary shares of the Company are set out below:

| | **31 August 2014** | 31 August 2013 |
|---|---|---|
| Dennis Millard | **85,000** | 85,000 |
| Andrew Brent | **10,101** | 10,101 |
| Anthony Cann | **30,000** | 30,000 |
| John Worby | **12,000** | 12,000 |

There has been no change in the non-executive directors' shareholdings shown above between 1 September 2014 and 15 October 2014.

**Shareholding requirements**
The Company's shareholding guidelines were introduced in January 2009 and, following the review of remuneration arrangements carried out last year, now require executive directors to build up over a period of five years and then maintain a target holding of ordinary shares of 150% of salary (previously 100% of salary) and other members of the executive management team to build up over a period of five years and then maintain a target holding of 100% of salary (previously 75% of salary) and until that level is reached, except for payment of tax arising on the exercise of awards and other exceptional circumstances, they will not be allowed to sell shares beyond 25% of shares vesting under share incentive arrangements.

In exceptional circumstances, executive directors may seek permission from the Remuneration Committee temporarily to go below their target holding. During the prior year Jonathan Bunting was given permission by the Remuneration Committee to sell his holding of 180,174 shares in order to part-fund his relocation on the understanding that he would build up a holding of 100% of salary as soon as possible and a holding of 150% of salary by June 2018 (the additional 50% holding introduced in June 2013 being built up at the rate of 10% each year between 2013 and 2018).

Assuming a market price of 150p, Jonathan Bunting currently holds shares with a value of 47% of salary, Mark Cashmore currently holds shares with a value of 159% of salary and Nick Gresham, who joined the Group on 1 August 2010, holds shares with a value of 82% of salary (against a pro-rata target of 90% of salary).

**Employee Benefit Trust**
The Company's Employee Benefit Trust is used to facilitate the acquisition of ordinary shares in the Company for the purpose of satisfying options granted under the Company's executive share schemes. The Trust is a discretionary trust, the sole beneficiaries being employees (including executive directors) and former employees of the Company. The Trust waives its right to vote and to dividends on the shares that it holds. The Trustee is Computershare Trustees (Jersey) Limited, an independent professional trustee company based in Jersey.

The number of shares held in the Employee Benefit Trust at 31 August 2014 was 2,203,191. The accounting treatment is shown in the Group Statement of Changes in Equity on page 67.

**Dilution of share capital by employee share plans**
Awards granted under the Company's Sharesave Scheme are satisfied by the issue of new shares when the options are exercised. All other share plans are satisfied by market purchase shares. The Company monitors the number of shares issued under the Sharesave Scheme and as at 31 August 2014 had issued 1,800,379 new shares since 31 August 2006 (demerger), representing 0.95% of the issued share capital, well within the all share plans dilution limit of 10% in any rolling ten-year period set by the Investment Management Association.

**Performance graph and table**
The graph below illustrates the Company's Total Shareholder Return (TSR) performance (share price growth adjusted for reinvested dividends) against the FTSE Support Services Sector over the past five years. The FTSE Support Services Sector was chosen because it represents a broad equity market index of which the Company is a constituent. In line with the new regulations, the table below the graph sets out the remuneration data for the Group Chief Executive during each of the last five financial years (Mark Cashmore held this position for all five years).

TSR performance graph

Group Chief Executive remuneration

| | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|---|---|---|---|---|---|
| Group Chief Executive single figure of remuneration (£'000) | 846 | 862 | 1,079 | 1,311 | 970 |
| Annual bonus payment (% maximum) | 100.0% | 59.9% | 83.1% | 67.1% | 12.5% |
| EPP payout (% maximum) | 84.1% | 79.2% | 89.4% | 86.8% | 55.1% |
| LTIP vesting (% maximum) | 0.0% | 78.0% | 100.0% | 100.0% | 100.0% |

| | Date of grant | Number of shares at 1 September 2013 | Number of shares granted during the year | Number of shares exercised during the year | **Number of shares at 31 August 2014** | Option price (pence) | Share price on date of grant (pence) | Share price on date of exercise (pence) | Exercise period |
|---|---|---|---|---|---|---|---|---|---|
| **Nick Gresham** | | | | | | | | | |
| Deferred Bonus Plan | | | | | | | | | |
| FY2010/11 Annual Bonus Plan | 08.11.11 | 39,016 | – | 39,016 | – | 0.00 | 93.92 | 214.50 | 08.11.13-08.11.14 |
| FY2010/11 Economic Profit Plan | 08.11.11 | 13,545 | – | 13,545 | – | 0.00 | 93.92 | 214.50 | 08.11.13-08.11.14 |
| FY2011/12 Annual Bonus Plan | 15.11.12 | 34,530 | – | – | **34,530** | 0.00 | 152.92 | – | 15.11.14-15.11.15 |
| FY2011/12 Economic Profit Plan | 15.11.12 | 19,360 | – | – | **19,360** | 0.00 | 152.92 | – | 15.11.14-15.11.15 |
| FY2012/13 Annual Bonus Plan | 14.11.13 | – | 30,561 | – | **30,561** | 0.00 | 210.25 | – | 14.11.15-14.11.16 |
| FY2012/13 Economic Profit Plan | 14.11.13 | – | 28,031 | – | **28,031** | 0.00 | 210.25 | – | 14.11.15-14.11.16 |
| LTIP | | | | | | | | | |
| 2010 | 11.08.11 | 310,146 | – | 310,146 | – | 0.00 | 84.71 | 209.52 | 16.10.13-11.08.21 |
| 2011 | 17.11.11 | 87,340 | – | – | **87,340** | 0.00 | 93.17 | – | 15.10.14-17.11.21 |
| 2012 | 15.11.12 | 77,655 | – | – | **77,655** | 0.00 | 152.92 | – | Oct 2015-15.11.22 |
| 2013 | 14.11.13 | – | 63,615 | – | **63,615** | 0.00 | 210.25 | – | Oct 2016-14.11.23 |
| Sharesave Scheme | | | | | | | | | |
| 2011 | 01.06.11 | 4,473 | – | – | **4,473** | 80.70 | 94.50 | – | 01.08.14-31.01.15 |
| 2014 | 25.06.14 | – | 9,113 | – | **9,113** | 158.00 | 182.00 | – | 01.09.17-28.02.18 |
| **Total** | | 586,065 | 131,320 | 362,707 | **354,678** | | | | |

(a) Full details of the Annual Bonus Plan, Economic Profit Plan, Deferred Bonus Plan, LTIP and Sharesave Scheme are set out on pages 49 to 53.
(b) There are no further performance conditions attached to the Deferred Bonus Plan awards, which are exercisable subject only to continued employment.
(c) No option price is payable on either the grant or exercise of Deferred Bonus Plan and LTIP awards.
(d) The share price on the date of grant for Deferred Bonus Plan and LTIP awards is the average mid-market share price on the three dealing days prior to the date of grant, used to calculate the numbers of shares under awards.
(e) The number of shares shown under the LTIP is the maximum (100%) number that could be received by the executive director if the aggregate EPS performance targets as set out on page 52 are fully met.
(f) The maximum aggregate EPS performance target applicable to LTIP awards granted on 11 August 2011 was met and, as such, these awards vested and became exercisable in full on 16 October 2013.
(g) The award granted to Nick Gresham on 11 August 2011 in respect of 310,146 shares comprises a normal award of 35% of salary and an exceptional award of 78% of salary in respect of incentives foregone from his previous employer.
(h) The maximum aggregate EPS performance target applicable to LTIP awards granted on 17 November 2011 has been met and, as such, these awards vested and became exercisable in full on 15 October 2014.
(i) No awards or options have lapsed during the year ended 31 August 2014.
(j) No awards or options have been granted to or exercised by executive directors between 1 September 2014 and 15 October 2014.
(k) The market price of the shares at the end of the financial year was 153p (2013: 187.75p); the highest and lowest share price during the financial year were 138.5p and 247.75p respectively.
(l) The aggregate gains of directors arising from the exercise of Deferred Bonus Plan and LTIP awards in the year totalled £1,835,121.

The table below shows, in relation to each executive director, the total number of share options with and without performance measures, those vested but unexercised and those exercised during the year.

| | Share options | | | |
|---|---|---|---|---|
| | With performance measures[1] | Without performance measures[2] | Vested but unexercised | Exercised during the year |
| Jonathan Bunting | 315,549 | 212,206 | 91,949 | 166,265 |
| Mark Cashmore | 564,472 | 333,259 | 173,339 | 327,454 |
| Nick Gresham | 538,756 | 178,629 | 91,813 | 362,707 |

1 LTIP.
2 Deferred Bonus Plan and Sharesave Scheme.

The non-executive directors (including the Chairman) do not participate in the Company's share schemes.

**Executive directors' shareholdings (audited)**
The table below sets out the beneficial interests of the executive directors and their immediate families in the ordinary shares of the Company.

| | **31 August 2014** | 31 August 2013 |
|---|---|---|
| Jonathan Bunting | **87,962** | – |
| Mark Cashmore | **444,756** | 271,516 |
| Nick Gresham | **152,221** | – |

There has been no change in the executive directors' shareholdings shown above between 1 September 2014 and 15 October 2014.

Sharesave Scheme

The Company operates an HM Revenue and Customs Approved Save-As-You-Earn share option scheme (the 'Sharesave Scheme'), which is open to all employees (including executive directors) who have completed one year's service and who enter an approved savings contract for a term of three years. The maximum amount which can be saved is £500 per month, the total savings at the end of the term being used to purchase shares at 80% of their market value at the start of the savings contract. In common with most schemes of this type, there are no performance conditions applicable to options granted under the Sharesave Scheme.

**Executive directors' share interests (audited)**

The table below sets out details of outstanding share options held by executive directors.

| | Date of grant | Number of shares at 1 September 2013 | Number of shares granted during the year | Number of shares exercised during the year | **Number of shares at 31 August 2014** | Option price (pence) | Share price on date of grant (pence) | Share price on date of exercise (pence) | Exercise period |
|---|---|---|---|---|---|---|---|---|---|
| **Jonathan Bunting** | | | | | | | | | |
| Deferred Bonus Plan | | | | | | | | | |
| FY2010/11 Annual Bonus Plan | 08.11.11 | 39,895 | – | 39,895 | – | 0.00 | 93.92 | 230.96 | 08.11.13-08.11.14 |
| FY2010/11 Economic Profit Plan | 08.11.11 | 37,538 | – | 37,538 | – | 0.00 | 93.92 | 230.96 | 08.11.13-08.11.14 |
| FY2011/12 Annual Bonus Plan | 15.11.12 | 36,348 | – | – | **36,348** | 0.00 | 152.92 | – | 15.11.14-15.11.15 |
| FY2011/12 Economic Profit Plan | 15.11.12 | 27,730 | – | – | **27,730** | 0.00 | 152.92 | – | 15.11.14-15.11.15 |
| FY2012/13 Annual Bonus Plan | 14.11.13 | – | 30,846 | – | **30,846** | 0.00 | 210.25 | – | 14.11.15-14.11.16 |
| FY2012/13 Economic Profit Plan | 14.11.13 | – | 28,666 | – | **28,666** | 0.00 | 210.25 | – | 14.11.15-14.11.16 |
| LTIP | | | | | | | | | |
| 2010 | 11.08.11 | 88,832 | – | 88,832 | – | 0.00 | 84.71 | 230.96 | 16.10.13-11.08.21 |
| 2011 | 17.11.11 | 80,766 | – | – | **80,766** | 0.00 | 93.17 | – | 15.10.14-17.11.21 |
| 2012 | 15.11.12 | 81,742 | – | – | **81,742** | 0.00 | 152.92 | – | Oct 2015-15.11.22 |
| 2013 | 14.11.13 | – | 64,209 | – | **64,209** | 0.00 | 210.25 | – | Oct 2016-14.11.23 |
| Sharesave Scheme | | | | | | | | | |
| 2011 | 01.06.11 | 11,183 | – | – | **11,183** | 80.70 | 94.50 | – | 01.08.14-31.01.15 |
| **Total** | | 404,034 | 123,721 | 166,265 | **361,490** | | | | |
| **Mark Cashmore** | | | | | | | | | |
| Deferred Bonus Plan | | | | | | | | | |
| FY2010/11 Annual Bonus Plan | 08.11.11 | 68,657 | – | 68,657 | – | 0.00 | 93.92 | 212.50 | 08.11.13-08.11.14 |
| FY2010/11 Economic Profit Plan | 08.11.11 | 68,147 | – | 68,147 | – | 0.00 | 93.92 | 212.50 | 08.11.13-08.11.14 |
| FY2011/12 Annual Bonus Plan | 15.11.12 | 59,686 | – | – | **59,686** | 0.00 | 152.92 | – | 15.11.14-15.11.15 |
| FY2011/12 Economic Profit Plan | 15.11.12 | 48,187 | – | – | **48,187** | 0.00 | 152.92 | – | 15.11.14-15.11.15 |
| FY2012/13 Annual Bonus Plan | 14.11.13 | – | 41,464 | – | **41,464** | 0.00 | 210.25 | – | 14.11.15-14.11.16 |
| FY2012/13 Economic Profit Plan | 14.11.13 | – | 40,260 | – | **40,260** | 0.00 | 210.25 | – | 14.11.15-14.11.16 |
| LTIP | | | | | | | | | |
| 2010 | 11.08.11 | 190,650 | – | 190,650 | – | 0.00 | 84.71 | 208.67 | 16.10.13-11.08.21 |
| 2011 | 17.11.11 | 173,339 | – | – | **173,339** | 0.00 | 93.17 | – | 15.10.14-17.11.21 |
| 2012 | 15.11.12 | 107,736 | – | – | **107,736** | 0.00 | 152.92 | – | Oct 2015-15.11.22 |
| 2013 | 14.11.13 | – | 92,747 | – | **92,747** | 0.00 | 210.25 | – | Oct 2016-14.11.23 |
| Sharesave Scheme | | | | | | | | | |
| 2012 | 30.05.12 | 4,580 | – | – | **4,580** | 78.60 | 93.50 | – | 01.08.15-31.01.16 |
| 2014 | 25.06.14 | – | 2,278 | – | **2,278** | 158.00 | 182.00 | – | 01.09.17-28.02.18 |
| **Total** | | 720,982 | 176,749 | 327,454 | **570,277** | | | | |

# Directors' remuneration report continued

### Performance targets for outstanding LTIP awards (audited)

For awards granted on 11 August 2011, 17 November 2011, 15 November 2012 and 14 November 2013, the three year aggregate EPS targets are as follows:

| Date of Grant | Performance Period | Aggregate EPS performance target[1] | Proportion exercisable |
|---|---|---|---|
| 11 August 2011[2] | Three years ended 31 Aug 2013 | Below 47p | Zero |
| | | 47p | 20% |
| | | Pro-rating applies between these points | Between 20% and 100% |
| | | 51.5p or more | 100% |
| 17 November 2011[3] | Three years ended 31 Aug 2014 | Below 53.3p | Zero |
| | | 53.3p | 20% |
| | | Pro-rating applies between these points | Between 20% and 100% |
| | | 57.5p or more | 100% |
| 15 November 2012[3] | Three years ending 31 Aug 2015 | Below 64.5p | Zero |
| | | 64.5p | 20% |
| | | Pro-rating applies between these points | Between 20% and 100% |
| | | 71.5p or more | 100% |
| 14 November 2013 | Three years ending 31 Aug 2016 | Below 71p | Zero |
| | | 71p | 20% |
| | | Pro-rating applies between these points | Between 20% and 100% |
| | | 80p or more | 100% |

1 For the purposes of the above targets, EPS is determined by reference to basic earnings per share, as defined by IAS33, before non-recurring items and their associated tax impact, adjusted by the Committee as considered appropriate to ensure consistency.
2 Owing to the Company being in a prohibited period while negotiating the acquisition of Dawson Holdings PLC, and subsequently awaiting HMRC guidance on the operation of the Disguised Remuneration legislation enacted on 19 July 2011, the 2010 awards, which would normally have been granted in November 2010, were not granted until 11 August 2011.
3 For the purposes of measuring performance against targets, reported EPS for FY13, FY14 and FY15 has been/will be adjusted (as appropriate) to reflect the adoption of pension accounting standard IAS19 (revised) from 1 September 2013.

Details of all outstanding LTIP awards are set out in the table of executive directors' share interests on pages 53 and 54.

### LTIP awards granted in 2013/14 (audited)

On 14 November 2013, executive directors were granted awards of 50% of salary. The vesting of these awards is subject to the aggregate EPS performance targets over the performance period, as set out in the table above.

### LTIP awards vested on 16 October 2013 (audited)

Awards granted to executive directors on 11 August 2011 vested on 16 October 2013.

Measured on the basis described in Note 1 to the table above, aggregate EPS over three years ended 31 August 2013 is 57.8p, and resulted in 100% of the awards vesting and being exercisable from 16 October 2013.

### LTIP awards vested on 15 October 2014 (audited)

Awards granted to executive directors on 17 November 2011 vested on 15 October 2014.

Measured on the basis described in Note 1 to the table above, aggregate EPS over three years ended 31 August 2014 is 65.6p, and has resulted in 100% of the awards vesting and being exercisable from 15 October 2014.

### LTIP awards to be granted in 2014/15

During the year ending 31 August 2015, it is intended that executive directors will be granted LTIP awards of 50% of salary subject to EPS performance. The Committee will review the timing and determine the targets applicable to these awards during the year. Full details of the performance targets attached to these awards will be disclosed in a stock exchange announcement at the time of grant and in next year's directors' remuneration report.

### Share option schemes (audited)

#### Executive Share Option Scheme

The Company operates an Executive Share Option Scheme which is used to grant options to executives up to an annual limit of 200% of base salary. Options are granted at the prevailing market price and are exercisable after three years, subject to performance.

The Committee granted options on 14 November 2013, which will be exercisable from 14 November 2016 provided that Group underlying profit before tax for the year ending 31 August 2016 exceeds £53m. The Committee will conduct its annual review of the performance condition prior to the grant of options in late 2014.

The executive directors did not participate in this Scheme in the financial year ended 31 August 2014 and will not participate in the current financial year.

Economic Profit Plan for 2014/15
The Committee have reviewed and approved the Economic Profit Plan for 2014/15. The maximum bonus opportunity and the payments into the Pool at minimum, target and maximum levels of economic profit remain unchanged and are as described above. The targets are considered to be commercially sensitive and will be disclosed in next year's directors' remuneration report.

**Deferred Bonus Plan (audited)**
Under this plan, executive directors and key senior executives may be granted each year share awards (in the form of nil cost options) representing a proportion of the bonuses earned under the Annual Bonus Plan and/or Economic Profit Plan. The awards are normally exercisable after a holding period of two years, subject to continued employment.

The Committee may at any time amend or terminate the plan and, in line with best practice, malus and clawback provisions apply in the event of a material misstatement of the Company's financial results, material miscalculation of any performance metric, serious reputational damage to the Company or relevant business unit as a result of a participant's misconduct or gross misconduct of the participant.

Following the review of executive remuneration arrangements carried out during 2013, from 2013 onwards awards will attract dividend equivalents further to strengthen alignment with shareholders' interests. In line with best practice, an amount equal to dividends paid during the performance period will be paid retrospectively at the end of the performance period, either in cash or in shares, but only on the number of shares that ultimately vest. No dividends will be accrued on any part of an award that lapses.

As described under Annual Bonus Plan and Economic Profit Plan, for performance in the year under review, Jonathan Bunting, Mark Cashmore and Nick Gresham will be granted share awards under this plan with market values at the date of grant of £87,500, £26,250 and £28,000 respectively in connection with the Annual Bonus Plan and £38,598, £57,897 and £38,598 respectively in connection with the Economic Profit Plan. These awards will be granted as soon as practicable following the announcement of the Company's preliminary results in October 2014.

Details of deferred share awards granted to executive directors during the year can be found in the table of executive directors' share interests on pages 53 and 54.

**Long-Term Incentive Plan**
The LTIP is the primary long-term incentive for executive directors and key senior executives. The maximum opportunity under the plan rules is 200% of salary, although current policy is to grant awards to executive directors of 50% of salary and to key senior executives of up to 45% of salary. Awards are granted in the form of nil-cost options, the vesting of which is conditional on the achievement of performance targets.

The Committee reviews the performance measure and targets annually to ensure that they remain challenging, appropriate, and a driver of business strategy. In recent years, performance has been measured against aggregate earnings per share (EPS) over three years, which the Committee believes is the most appropriate measure of the Company's performance.

The Committee may at any time amend (subject to the approval of shareholders if the proposed amendments are to the advantage of existing or new participants) or terminate the plan and, in line with best practice, malus and clawback provisions apply in the event of a material misstatement of the Company's financial results, material miscalculation of any performance metric, serious reputational damage to the Company or relevant business unit as a result of a participant's misconduct or gross misconduct of the participant.

Following the review of executive remuneration arrangements carried out during 2013, from 2013 onwards, awards will attract dividend equivalents further to strengthen alignment with shareholders' interests. In line with best practice, an amount equal to dividends paid during the performance period will be paid retrospectively at the end of the performance period, either in cash or in shares, but only on the number of shares that ultimately vest. No dividends will be accrued on any part of an award that lapses.

### Annual Bonus Plan for 2014/15

The Committee have reviewed and approved the Annual Bonus Plan for 2014/15. The bonus opportunity remains unchanged at 100% of salary at maximum level of relevant profits with outstanding performance, 42.5% of salary at target level of relevant profits with high performance and 10% of salary at threshold level of relevant profits with good performance, as set out in the tables below.

| | Maximum level of bonus payable (% of salary) | | |
|---|---|---|---|
| | Group PBT | Smiths News PBT | Individual objectives |
| Jonathan Bunting | 20% | 50% | 30% |
| Mark Cashmore | 70% | – | 30% |
| Nick Gresham | 70% | – | 30% |

| | Target level of bonus payable (% of salary) | | |
|---|---|---|---|
| | Group PBT | Smiths News PBT | Individual objectives |
| Jonathan Bunting | 6.5% | 16% | 20% |
| Mark Cashmore | 22.5% | – | 20% |
| Nick Gresham | 22.5% | – | 20% |

| | Threshold level of bonus payable (% of salary) | | |
|---|---|---|---|
| | Group PBT | Smiths News PBT | Individual objectives |
| Jonathan Bunting | 0% | 0% | 10% |
| Mark Cashmore | 0% | – | 10% |
| Nick Gresham | 0% | – | 10% |

The achievement of profit targets remains essential to Connect Group's success and, as such, 70% of the maximum bonus opportunity will continue to be measured against profitability targets, with the remaining 30% based on personal performance. Target profits will continue to be based on the achievement of stretching performance, whilst maximum level will require performance significantly beyond market expectations. The targets are considered to be commercially sensitive and will be disclosed in next year's directors' remuneration report.

Of any bonus payable, one half will be paid in cash and one half in the form of a share award to be granted under the terms of the Deferred Bonus Plan.

### Economic Profit Plan

Under this plan, which was introduced in 2008, executive directors and key senior executives may receive each year a cash payment and/or be granted a share award under the terms of the Deferred Bonus Plan, based on the value of an economic Pool. The value of the Pool is determined by the economic profit (calculated as profit after tax less the cost of capital employed) created in each financial year, the percentage of economic profit paid into the Pool each year being determined by the achievement of economic profit targets set annually based on the business plan. One third of the Pool is then distributed to participants each year (allocated in the proportion of each participant's base salary to the participants' total base salaries) and two thirds is carried forward to form part of the Pool for the following year. The main objectives of the plan are to retain key executives and to incentivise the executive management team to generate profits over and above the Group's cost of capital.

The Committee may at any time amend or terminate the plan and, in line with best practice, malus and clawback provisions apply in the event of a material misstatement of the Company's financial results, material miscalculation of any performance metric, serious reputational damage to the Company or relevant business unit as a result of a participant's misconduct or gross misconduct of the participant.

### Economic Profit Plan for 2013/14 (audited)

The table below sets out the payments into the Pool at minimum, target and maximum levels of economic profit.

| Target (Economic Profit) | Rationale | Payment into Pool |
|---|---|---|
| Minimum | EP at business plan minimum PBT | 2.5% of EP |
| Target | EP at business plan target PBT | 5.0% of EP |
| Maximum | EP at business plan maximum PBT | 7.5% of EP |

Each executive director was able to receive an allocation of up to 50% of base salary, of which half is paid in cash and half is paid in the form of shares, the receipt of which is deferred for two years (see Deferred Bonus Plan below).

The economic profit generated in the year to 31 August 2014 of £11.3m being less than the minimum target of £11.8m, resulted in no contribution to the Pool, leaving the value of the Pool from previous years at £1,298,000. Of this Pool, Mark Cashmore will receive £115,794, representing 27.6% of base salary, Nick Gresham will receive £77,196, representing 27.6% of base salary and Jonathan Bunting will receive £77,196, representing 27.6% of base salary. Of these payouts, half will be paid in cash in November 2014 and half will be paid in the form of a share award to be granted under the terms of the Deferred Bonus Plan.

As part of the Company's pension arrangements, the dependants of Jonathan Bunting are eligible for payment of a lump sum in the event of death-in-service equivalent to eight times salary. The dependants of Mark Cashmore and Nick Gresham are eligible for payment of a lump sum in the event of death-in-service equivalent to four times salary.

**Annual Bonus Plan**

The Annual Bonus Plan is designed to incentivise and reward execution of the Company's strategy over the short and medium-term. The bonus potential for executive directors is up to 100% of salary for 'maximum' performance. Payments are delivered through a mix of cash and shares, the balance of which is determined annually by the Committee. Shares are delivered in the form of nil-cost options under the Deferred Bonus Plan and vest after two years subject to continued employment.

In line with best practice, clawback provisions apply to cash bonuses paid and malus and clawback provisions apply to share awards granted from 2014 onwards.

Performance measures and targets are determined annually by the Committee to reflect prevailing financial, strategic and personal objectives. The majority of the bonus is based on financial performance.

Annual Bonus Plan for 2013/14 (audited)

The tables below set out the measures and bonus payable at maximum, target and threshold levels of performance, set at the beginning of the financial year, for each executive director.

| | Maximum level of bonus payable (% of salary) | | | |
|---|---|---|---|---|
| | Group PBT[a] | Smiths News PBT[a] | Strategic objectives[b] | Individual objectives[c] |
| Jonathan Bunting | 35% | 35% | 15% | 15% |
| Mark Cashmore | 70% | – | – | 30% |
| Nick Gresham | 70% | – | 15% | 15% |

| | Target level of bonus payable (% of salary) | | | |
|---|---|---|---|---|
| | Group PBT[a] | Smiths News PBT[a] | Strategic objectives[b] | Individual objectives[c] |
| Jonathan Bunting | 11.25% | 11.25% | 10% | 10% |
| Mark Cashmore | 22.5% | – | – | 20% |
| Nick Gresham | 22.5% | – | 10% | 10% |

| | Threshold level of bonus payable (% of salary) | | | |
|---|---|---|---|---|
| | Group PBT[a] | Smiths News PBT[a] | Strategic objectives[b] | Individual objectives[c] |
| Jonathan Bunting | 0% | 0% | 5% | 5% |
| Mark Cashmore | 0% | – | – | 10% |
| Nick Gresham | 0% | – | 5% | 5% |

(a) No bonus is payable in respect of this part of the plan unless profit before tax exceeds the threshold target. A pro-rata bonus is payable for profits between threshold and target and between target and maximum.

(b) Strategic objectives reflect key areas of focus for the Group relevant to each director's business area to ensure the strategic success of the Company, each objective having targets set for minimum, target and maximum levels of achievement. A bonus is only payable for the achievement of strategic objectives if there has been an increase in underlying Group PBT.

(c) Individual performance is rated at minimum ('good performance'), target ('high performance') or maximum ('outstanding performance'), dependant on the achievement of individual objectives. The Committee retains discretion to rate an individual between these points and to pay a pro-rata bonus in respect of this part of the plan should it wish to do so. A bonus is only payable for the achievement of individual objectives if there has been an increase in underlying Group PBT.

Each executive director had the opportunity to receive an annual bonus up to a maximum of 100% of salary (42.5% at target level; 10% at threshold level), as set out in the tables above, one half of which is payable in the form of shares, the receipt of which is deferred for two years (see Deferred Bonus Plan on page 51).

As the threshold Group underlying profit before tax target of £53.9m was not met, no bonuses are payable in respect of that part of the plan. As a result of exceeding the maximum Smiths News PBT target of £40.3m and the achievement of strategic and individual objectives, Jonathan Bunting's annual bonus for the year under review is £175,000, representing 62.5% of salary; as a result of the achievement of individual objectives, Mark Cashmore's annual bonus for the year under review is £52,500, representing 12.5% of salary; and as a result of the achievement of strategic and individual objectives, Nick Gresham's annual bonus for the year under review is £56,000, representing 20% of salary. Of these bonuses, half will be paid in cash in November 2014 and half will be paid in the form of a share award to be granted under the terms of the Deferred Bonus Plan.

## Annual report on remuneration

This section of the Directors' remuneration report details the implementation of the directors' remuneration policy (as described on pages 42 to 47) during the year ended 31 August 2014 and for the forthcoming year. For ease of comparison, in this section the arrangements for 2014/15 for the Annual Bonus Plan, EPP and LTIP are set out alongside the arrangements for the reporting year.

**Executive directors**

**Executive directors' 'single figure' of remuneration for 2013/14 and 2012/13 (audited)**

The table below sets out the single total figure of remuneration for each of the executive directors for the financial year ended 31 August 2014.

| | Year | Salary £'000 | Benefits[a] £'000 | Annual Bonus[b] £'000 | Economic Profit Plan[c] £'000 | LTIP[d] £'000 | Pension benefits[e] £'000 | **Total £'000** |
|---|---|---|---|---|---|---|---|---|
| Jonathan Bunting | 2013/14 | 277 | 26 | 175 | 77 | 132 | 55 | **742** |
| | 2012/13 | 263 | 337 | 195 | 120 | 187 | 57 | **1,159** |
| Mark Cashmore | 2013/14 | 410 | 26 | 52 | 116 | 284 | 82 | **970** |
| | 2012/13 | 370 | 25 | 261 | 170 | 400 | 85 | **1,311** |
| Nick Gresham | 2013/14 | 276 | 16 | 56 | 77 | 143 | 57 | **625** |
| | 2012/13 | 258 | 14 | 193 | 118 | 651 | 55 | **1,289** |

(a) Benefits include the taxable value of a company car or car cash allowance, private medical insurance, relocation expenses and the intrinsic value of Sharesave options granted during the year, as applicable to each director and as described on page 53.
(b) Half of any award will be deferred into Company shares for a period of two years. Further details of the 2013/14 Annual Bonus Plan are shown on page 49.
(c) Half of any award will be deferred into Company shares for a period of two years. Further details of the 2013/14 Economic Profit Plan are shown on page 50.
(d) The awards reported in 2013/14 were granted on 17 November 2011 and vested on 15 October 2014 (based on performance to 31 August 2014). They have been valued at 164p, being the market price of the shares on the date of vesting. Jonathan Bunting's award is in respect of 80,766 shares; Mark Cashmore's award is in respect of 173,339 shares; and Nick Gresham's award is in respect of 87,340 shares. The awards reported in 2012/13 were granted on 11 August 2011 and vested on 16 October 2013 (based on performance to 31 August 2013). They have been valued at 210p, being the market price of the shares on the date of vesting. Jonathan Bunting's award is in respect of 88,832 shares; Mark Cashmore's award is in respect of 190,650 shares; and Nick Gresham's award is in respect of 310,146 shares. Further details on these awards can be found on page 52.
(e) Pension benefits comprise total pension supplement, whether taken as an addition to basic pay or pension contribution, and Company pension contribution. The prior year figures (as reported in last year's directors' remuneration report) have been reduced by £958 for Jonathan Bunting, £3,304 for Mark Cashmore and £2,010 for Nick Gresham in respect of amounts recovered in 2013/14 relating to overpayments in 2012/13.
(f) All of the executive directors served throughout the year.

**Salary (audited)**

The salaries of executive directors are reviewed annually, with any new salaries normally taking effect from 1 January. When conducting any review, the Committee takes into account a range of factors including the Group's performance, changing size and complexity, market conditions, the prevailing market rates for similar positions in a comparable group of companies, the responsibilities, individual performance and experience of each executive director and the level of salary increases awarded to employees throughout the Group.

Following the comprehensive review of executive remuneration arrangements carried out during 2012/13, a number of changes were implemented. They included a phased increase in salaries over two years (balanced by a significant reduction in pension benefits taken over one year), as set out below.

| | 1 September 2012 | Effective from 1 January 2013 | Current salary (effective from 1 January 2014) |
|---|---|---|---|
| Jonathan Bunting | £250,000 | £270,000 (+8.0%) | £280,000 (+3.7%) |
| Mark Cashmore | £329,500 | £390,000 (+18.4%) | £420,000 (+7.7%) |
| Nick Gresham | £237,500 | £267,500 (+12.6%) | £280,000 (+4.7%) |

The context and rationale for these salary increases is set out in last year's Directors' remuneration report.

New salaries effective from 1 January 2015 have not yet been determined for executive directors, however, any increase is expected to be in line with salary increases for employees throughout the Group.

**Benefits (audited)**

Each executive director receives a car or car cash allowance and private medical insurance. The Company may also provide other benefits such as relocation expenses to reflect specific individual circumstances.

Following his appointment as Managing Director, Smiths News on 1 May 2012, in accordance with the Company's relocation policy and to enable him to devote more time to the business, the Company paid total relocation expenses for Jonathan Bunting amounting to £184,266. The gross taxable value amounted to £332,577, of which £17,647 was incurred in 2011/12 and included in remuneration for that year and £314,930 was included in remuneration for 2012/13.

**Pension benefits (audited)**

The executive directors participate in the Company's defined contribution pension schemes. Jonathan Bunting participates in the money purchase section of the WH Smith Pension Trust and Mark Cashmore and Nick Gresham participate in the Smiths News section of the WH Smith Retirement Savings Plan. Under these plans executive directors contribute up to 5% of salary which is matched by the Company. In addition, each executive director receives a 15% salary supplement in lieu of pension, which may be taken as an additional pension contribution or as an addition to basic pay.

### Non-executive directors

**Policy table for non-executive directors**

The table below sets out the Company's remuneration policy for non-executive directors.

| Element | Purpose and link to strategy | Operation |
|---|---|---|
| Chairman and non-executive directors basic fee | To attract and retain high calibre individuals to serve as non-executive directors. | Fee levels are set to reflect the time commitment, demands and responsibility of the role, taking into account fees paid by similarly sized companies.<br><br>The Chairman's fee is determined by the Committee and the non-executive directors' fees are determined by the Chairman and executive directors.<br><br>Fees are reviewed from time to time to ensure that they remain in line with market practice.<br><br>Fees are paid in equal monthly instalments.<br><br>The Chairman's fee includes his chairmanship of the Nominations Committee.<br><br>The maximum aggregate fees for non-executive directors, including the Chairman, is £500,000 p.a., as set out in the Company's Articles of Association. |
| Additional fees | To provide compensation to non-executive directors taking on additional Committee responsibility. | Non-executive directors (other than the Chairman) are paid an additional fee for their chairmanship of a Board committee. |
| Benefits | To facilitate the execution of the role. | The Company reimburses reasonable travel and subsistence costs.<br><br>The Chairman and non-executive directors do not participate in any pension or incentive plans. |

**Recruitment policy**

The remuneration package for a newly appointed non-executive director would be in line with the policy outlined above.

**Letters of appointment**

All non-executive directors, including the Chairman, have a letter of appointment for an initial three-year term, subject to review thereafter; these are available for inspection at the Company's registered office during normal business hours and at the AGM. Appointments may be terminated by either party giving three months' notice. In line with the UK Corporate Governance Code, all non-executive directors are subject to annual re-election by shareholders at the AGM.

In the event that the employment of an executive director is terminated, any compensation payable will be determined in accordance with the terms of the service contract as well as the rules of any incentive plans. In the event of termination, the following will apply:

| | |
|---|---|
| **Annual Bonus** | Unless the Committee determines otherwise, there is no participation in the Annual Bonus in respect of the financial year in which cessation occurs.<br><br>The Committee retains discretion to allow participation in respect of the financial year in which cessation occurs where considered appropriate, and in these circumstances the maximum opportunity would normally be reduced pro-rata to reflect the portion of the year in employment and any payment would remain subject to performance and, if practicable, would be assessed and paid (in cash) following the normal year end assessment process. |
| **EPP** | Unless the Committee determines otherwise, there will be no distribution from the EPP in respect of the financial year in which cessation occurs.<br><br>The Committee retains discretion to allow a distribution in respect of the financial year in which cessation occurs where considered appropriate, and in these circumstances the maximum opportunity would normally be reduced pro-rata to reflect the portion of the year in employment and any payment would remain subject to the original calibration of the EPP performance framework for that year and would be assessed and paid (in cash) as part of the normal year end assessment process. No further distributions may be made and all rights in respect of the Pool would lapse. |
| **DBP** | If cessation of employment occurs by reason of death, injury, disability, redundancy, retirement by agreement with the Company, or the employing entity no longer being part of the Group, the deferred shares will vest and will remain exercisable up to six months after the date of cessation (except where cessation is by reason of death, when awards remain exercisable for a period of 12 months).<br><br>If cessation occurs for any other reason, the extent to which the shares vest and the period in which they can be exercised will be determined at the discretion of the Committee. |
| **LTIP** | If cessation of employment occurs by reason of death, injury, ill-health, disability, redundancy, retirement by agreement with the Company, or the employing entity no longer being part of the Group, LTIP awards will be reduced to reflect the proportion of the performance period that has elapsed at the date of cessation (unless the Committee determines that exceptional circumstances apply and that a greater proportion should vest) and will become exercisable, to the extent that the award vests in accordance with the performance conditions, on the original vesting date.<br><br>If cessation occurs for any other reason, the award will lapse unless the Committee determines that exceptional circumstances apply, in which case the award will be reduced to reflect the proportion of the performance period that has elapsed at the date of cessation and will become exercisable, to the extent that the award vests in accordance with the performance conditions, on the original vesting date.<br><br>Vested awards will remain exercisable up to six months after the date of cessation (except where cessation is by reason of death, when awards remain exercisable for a period of 12 months). |

The Committee retains discretion to make additional exit payments where such payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation) or by way of settlement or compromise of any claim arising in connection with the termination of a director's office or employment. The details and rationale for any such payments would be disclosed in the annual report on remuneration.

**External appointments**
It is the Company's policy to allow each executive director to accept one non-executive directorship of a publicly quoted company provided that it is not a chairmanship of a FTSE 100 company and it does not conflict with the interests of the Company. Executive directors may retain the fee for such an appointment. The executive directors do not currently hold any non-executive directorships.

**Consideration of pay and employment conditions elsewhere in the Group**
The Committee considers the general basic salary increase and employment conditions for employees throughout the Group, including trade union represented employees, when determining the annual salary increases and remuneration of the executive directors. Employees have not been directly consulted on the design of the Company's senior executive remuneration policy.

**Consideration of shareholder views**
The views of shareholders are very important to the Committee and feedback received from shareholders following publication of the Annual Report and at the AGM is welcomed. It is the Committee's policy to consult with major shareholders and investor representative bodies before proposing any material changes to the remuneration policy.

**Approach to recruitment remuneration**
On appointment of a new executive director, the Committee would seek to offer a remuneration package which can secure an individual with the necessary skills and experience to help deliver the business strategy, while seeking to pay no more than it believes is necessary to facilitate the appointment.

Executive directors would be appointed on a remuneration package in line with the policy table for executive directors. Salaries would be set at an appropriately market competitive level to reflect skills and experience, and, if considered appropriate, the Committee may set salaries towards the lower end of the market range to allow future salary progression to reflect performance in role. In accordance with the policy table, the Committee also has discretion to include other benefits such as housing or relocation benefits, if relevant to reflect specific individual circumstances. The maximum level of variable remuneration which may be awarded (excluding any compensatory awards referred to below) would be as set out in the policy table.

Where an individual forfeits outstanding incentive awards with a previous employer as a result of accepting appointment within the Group, the Committee may offer compensatory awards to facilitate recruitment. These awards would be in such form as the Committee considers appropriate taking into account all relevant factors including the form, expected value, performance conditions, anticipated vesting and timing of the forfeited awards. The value of any compensatory awards would be no higher than the value forfeited. While cash may be included to reflect the forfeiture of cash-based incentive awards, the Committee does not envisage that substantial 'golden hello' cash payments would be offered.

Any share awards referred to in this section will be granted as far as possible under the Company's existing share and incentive plans. If necessary, awards may be granted outside of these plans as currently permitted under the Listing Rules, but in accordance with the principles and limits set out in this section.

**Contracts of service and loss of office policy**
The contracts of employment with the executive directors are rolling contracts which were entered into on the dates shown in the table below. It is the Company's policy to enter into contracts of employment with executive directors which may be terminated at any time by the Company upon 12 months' notice and upon nine months' notice by the executive director. The contracts of employment do not include any provisions for pre-determined compensation for early termination. The Committee may terminate the contract immediately by making a payment in lieu of notice consisting of base salary only for the unexpired period of notice. In normal circumstances, such a payment would be made in monthly instalments over the period, subject to a duty to mitigate, and will be reduced by the amount in respect of income receivable from alternative employment.

| | Date of contract | Notice period by Company | Notice period by director |
|---|---|---|---|
| Jonathan Bunting | 1 April 2010 | 12 months | 9 months |
| Mark Cashmore | 5 September 2013 | 12 months | 9 months |
| Nick Gresham | 23 August 2010 | 12 months | 9 months |

| Element | Purpose and link to strategy | Operation | Maximum | Performance metrics |
|---|---|---|---|---|
| **LTIP** | To incentivise and recognise execution of the business strategy, delivery of performance and shareholder value over the longer term.<br><br>Also provides longer term alignment with shareholders and assists retention. | Executive directors are eligible to receive awards under the Connect Group Long-term Incentive Plan (LTIP) first approved by shareholders in 2006, at the discretion of the Committee each year.<br><br>Awards are made in the form of nil-cost options, the vesting of which is conditional on the achievement of performance targets.<br><br>The Committee may at any time amend (subject to shareholders approval if the proposed amendments are to the advantage of existing or new participants) or terminate the plan. Clawback and dividend equivalent provisions apply (see the notes below). | Under the rules of the plan, the maximum award in respect of a financial year is 200% of salary.<br><br>The current level of award is 50% of salary as described on pages 51 and 52 of this report. | Vesting is based on the achievement of performance targets set in respect of key Group financial performance measures over a period of at least three years, currently earnings per share (EPS).<br><br>For achievement of threshold performance target, a maximum of 20% of the award will vest. |

Notes to the policy table

(a) Legacy and mandated payments
The Committee reserves the right to make any remuneration payments and payments for loss of office (including exercising any discretions available to it in connection with such payments) notwithstanding that they are not in line with the policy set out above (i) where the terms of the payment were agreed before the policy came into effect or (ii) where the terms of the payment were agreed at a time when the relevant individual was not a director of the Company and, in the opinion of the Committee, the payment was not in contemplation of the individual becoming a director of the Company or (iii) where the Company is mandated to make the payment as a result of an award issued by a competent court, tribunal or authority. For these purposes 'payments' includes the Committee satisfying awards of variable remuneration and, in relation to an award over shares, the terms of the payment are 'agreed' at the time the award is granted.

(b) Dividend equivalents
For awards under the DBP and LTIP made in 2013 and in subsequent years, the Committee may determine that participants be entitled to receive an amount equal to the value of dividends paid during the deferral/vesting period, paid retrospectively at the end of the period, either in cash or shares, but only in respect of the number of shares that vest.

(c) Clawback
The Company operates clawback and malus provisions across all of its incentive plans (annual bonus, EPP, LTIP). The Committee reserves the right to take such action as it reasonably considers appropriate to put the Company and participants in the same overall financial position as they would have been had certain circumstances (described below) not occurred. This includes a reduction or cancellation of unvested share awards and/or a reimbursement to the Company of part or all of any cash or share payments received if those circumstances occur within two years of payment. Such circumstances include, but are not limited to: (a) discovery of a material misstatement of the Company's audited results on the basis of which the payment was or would be determined; or (b) serious reputational damage of the Company, any member of the Group or the relevant business unit as a result of the participant's misconduct; or (c) gross misconduct by the participant.

### Application of the remuneration policy

The charts below illustrate how the composition of the executive directors' remuneration packages varies at different levels of performance in the first year to which the remuneration policy applies, both as a percentage of total remuneration and as a total value:

(a) Fixed pay comprises base salary, benefits and pension benefits.
(b) The base salary is at 15 October 2014.
(c) The value of benefits receivable under these scenarios is taken to be the value of benefits received in 2013/14 (as calculated under the single figure of remuneration, set out on page 48).
(d) The value of pension benefits under these scenarios is 20% of salary, comprising a pension supplement of 15% of salary and a Company pension contribution of 5% of salary.
(e) The on-target level of annual bonus is 42.5% of the maximum opportunity (100% of salary for all executive directors). Further details can be found on page 50.
(f) The on-target level of EPP payout is 60% of the maximum opportunity (50% of salary for all executive directors).
(g) The on-target level of vesting under the LTIP is 60% (being midway between threshold vesting (20%) and maximum vesting (100%) of the value of the award at grant (50% of salary for all executive directors).
(h) The maximum value of the LTIP is 100% of the value of the award at grant and does not include any share price appreciation.

| Element | Purpose and link to strategy | Operation | Maximum | Performance metrics |
|---|---|---|---|---|
| **Annual Bonus** | To incentivise and reward execution of the strategy and delivery of annual performance.<br><br>Deferral provides longer term alignment with shareholders and assists retention. | Executive directors are eligible to participate at the discretion of the Committee each year.<br><br>Payout levels are determined by the Committee after year end based on performance against targets set at the start of the year. The Committee retains discretion to adjust bonus payments in the event that performance against targets does not properly reflect the underlying performance of the Group and/or relevant business divisions.<br><br>Half of the bonus is deferred into shares for two years, subject to continued employment under the terms of the Deferred Bonus Plan (DBP). In future years, the Committee retains discretion to change the deferred amount and/or the deferral period.<br><br>Clawback and dividend equivalent provisions apply (see notes below). | Annual maximum opportunity is 100% of salary. | Performance is assessed over one financial year using performance measures and targets determined annually by the Committee to reflect prevailing financial, strategic and personal objectives. The majority of the bonus will be based on financial performance.<br><br>For individuals with responsibility for a specific business unit, performance measures and targets specific to the performance of that business unit may be included. The current performance measure framework is disclosed on page 50.<br><br>Achievement of threshold performance will result in payment of 10% of salary. The amount payable in respect of achievement of target performance is determined by the Committee on an annual basis. |
| **Economic Profit Plan** | To incentivise and reward capital efficient generation of profits over and above the cost of capital.<br><br>The pooling of amounts for future years and the element of deferral provides longer term alignment with shareholders and assists retention. | Executive directors are eligible to participate in the EPP at the discretion of the Committee each year.<br><br>In respect of each financial year, a percentage of the Economic Profit created in that year is allocated to an Economic Profit Pool (the Pool).<br><br>Each year, one third of the Pool is distributed to participants and the remaining two thirds is carried forward to future years. Distributions to participants are in proportion to their base salaries, subject to the maximum described in this table.<br><br>Half of the annual distribution from the Pool is deferred into shares for two years, subject to continued employment under the terms of the DBP. In future years, the Committee retains discretion to change the deferred amount and/or the deferral period.<br><br>The Committee may at any time amend or terminate the plan. Clawback and dividend equivalent provisions apply (see the notes below). | Maximum amount that can be distributed to a participant in any one year is 50% of salary. | Economic Profit is defined as Profit After Tax less the Company's cost of capital employed, calculated in respect of a financial year. For the purposes of this calculation, as-reported Profit After Tax is used and the cost of capital represents the as-reported interest charge on the Company's debt and a notional charge for equity calculated based on the average as-reported equity. The Committee retains discretion to make adjustments to the calculation to ensure it remains fair and reasonable.<br><br>The percentage of Economic Profit allocated to the Pool each year is dependent on the Economic Profit generated. Where the Economic Profit is below a minimum target, no allocation to the Pool will be made. Where the Economic Profit is negative, the value of the Pool will be reduced. |

# Directors' remuneration report continued

**Introduction**

This report has been prepared on behalf of the Board by the Remuneration Committee, in accordance with the relevant provisions of the Companies Act 2006 and on the basis prescribed in The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. Where required, data has been audited by Deloitte LLP and is indicated accordingly.

## Remuneration policy report

This section of the remuneration report sets out the Company's policy on remuneration for executive and non-executive directors, and will be proposed for approval by shareholders at the AGM on 4 February 2015. It will, if approved, take effect from 4 February 2015 and may operate for up to three years.

The policy remains to attract, retain and motivate high calibre directors and senior managers with the necessary skills to deliver the Group's strategy within a framework designed to promote the long-term success of Connect Group, aligned with shareholder interests. In forming the policy the Committee has adopted the principles set out in Section D of the UK Corporate Governance Code.

**Executive directors**

**Policy table for executive directors**

The table below sets out the Company's remuneration policy for executive directors.

| Element | Purpose and link to strategy | Operation | Maximum | Performance metrics |
|---|---|---|---|---|
| **Salary** | To provide a core, fixed amount of reward for the role, which reflects the skills and experience of the individual and the size and scope of the role, sufficient to recruit and retain individuals of the necessary calibre to execute the strategy. | Salaries are set by the Committee taking into account:<br>– The skills and experience of the individual,<br>– The size and scope of the role,<br>– Market data for similar roles in comparable companies,<br>– Performance of the individual and the business.<br><br>Normally, salaries are reviewed annually with any changes effective from 1 January each year. Salaries from 1 September 2014 to 31 December 2014 are disclosed on page 48. Salaries with effect from 1 January 2015 have not yet been determined. | There is no prescribed maximum salary. Salary increases will normally be in line with salary increases for employees throughout the Group.<br><br>However, larger increases may be awarded where the Committee considers it appropriate to reflect, for example:<br>– Significant changes in the size and complexity of the Group and/or of the role<br>– Individuals being moved to market positioning over time. | None. |
| **Benefits** | To provide market competitive benefits for the nature and location of the role, sufficient to recruit and retain individuals of the necessary calibre to execute the strategy. | Executive directors are eligible to receive a market competitive benefits package which may include: a company car (or cash equivalent), private medical insurance and permanent health insurance.<br><br>Where relevant, other benefits to reflect specific individual circumstances, such as housing, relocation, travel, or expatriate allowances may also be provided.<br><br>Executive directors may participate in the Company's all employee share plans on the same basis as other employees. | Benefit provision, for which there is no prescribed monetary maximum, is set at a level which the Committee considers to be appropriate for the nature and location of the role.<br><br>Participation in all-employee share plans is subject to statutory limits. | None. |
| **Pension** | To provide an appropriate and market competitive pension benefit, sufficient to recruit and retain individuals of the necessary calibre to execute the strategy. | Executive directors may participate in the Group's defined contribution pension schemes, under which a personal contribution of up to 5% of salary will be matched by the Company. Additional contributions, to the defined contribution scheme or as a non-pensionable salary supplement, may also be made. Under the terms of the Group's defined contribution pension schemes, executive directors may also receive death in service benefit. | The maximum aggregate employer contribution/ salary supplement is 20% of salary. | None. |

# Directors' remuneration report

## Annual statement from the Chairman of the Remuneration Committee

**Dear Shareholder**
On behalf of the Board, I am pleased to present the Directors' remuneration report for the year ended 31 August 2014. This is our first year under the new reporting regime and consequently this year's report has been split into two separate sections:

- The remuneration policy report on pages 42 to 47, which will be subject to a binding vote at our 2015 AGM; and
- The annual report on remuneration on pages 48 to 57, which will be subject to an advisory vote.

**Key remuneration decisions during the year**
During 2012/13, we undertook a comprehensive review of our executive remuneration arrangements, consulted with our major shareholders and investor representative bodies and, in the light of those consultations, implemented a number of changes, as described in last year's report. The Committee always keeps executive remuneration arrangements under review in light of market and best practice, but as might be expected following an extensive review there have been no significant changes to executive remuneration during 2013/14.

The only change during the year was the planned second phase of the salary increases as a result of the 2013 review. This was in direct response to shareholder preference for the agreed increases to be staggered over two years as explained in last year's Directors' remuneration report.

**Pay and performance in FY2013/14**
The Annual Bonus Plan threshold Group underlying profit before tax target for 2013/14, which represents 70% of the maximum bonus opportunity for Mark Cashmore and Nick Gresham, and 35% of the maximum bonus opportunity for Jonathan Bunting, was not met. Reflecting this, Mark Cashmore's annual bonus is 12.5% of maximum and Nick Gresham's annual bonus is 20.0% of maximum. Reflecting Smiths News exceeding its maximum profit before tax target, which represents 35% of Jonathan Bunting's maximum bonus opportunity, Jonathan Bunting's annual bonus is 62.5% of maximum.

The Economic Profit Plan (EPP) minimum economic profit target was not met and, as such, there is no contribution to the EPP pool in respect of 2013/14. Reflecting this, the EPP payout (being one third of the value of the pool from previous years' performance) for each of the executive directors is 27.6% of salary, being 55.1% of the maximum opportunity.

The LTIP awards granted in November 2011 were measured for the three-year period up to 31 August 2014 against challenging aggregate EPS targets. As a result of performance exceeding the maximum target, these awards vested in full on 15 October 2014.

Further details on the operation of each of these plans are set out on pages 49 to 52.

**Executive remuneration for FY2014/15**
Salary increases are effective from 1 January onwards and have not yet been determined for executive directors. Any increase is expected to be in line with salary increases for employees throughout the Group.

There will be no change in maximum incentive opportunities. This remains at 100% of salary for our annual incentive and 100% of salary for long-term incentives (split between EPP and LTIP), for all executive directors.

The following table provides an executive summary of the remuneration arrangements expected to apply for executive directors for the financial year ending 31 August 2015:

| FY2014/15 | Mark Cashmore | Nick Gresham | Jon Bunting |
|---|---|---|---|
| Current salary | £420,000 | £280,000 | £280,000 |
| Salary (w.e.f. 1 January 2015) | To be determined, increases in line with all employees | | |
| Annual bonus maximum opportunity | 100% of salary | | |
| Long-term incentive maximum opportunity | 100% of salary (split between EPP and LTIP) | | |
| Pension | 20% of salary | | |

**Concluding remarks**
The Committee believes that it has established remuneration arrangements consistent with the Group's strategic objectives and in line with general institutional guidelines. The Committee takes an active interest in and welcomes shareholders' views. We pay close attention to the voting on the remuneration report and hope to receive your support for both resolutions at the forthcoming AGM.

**Anthony Cann**
Chairman of the Remuneration Committee

# Nominations Committee report continued

To facilitate increased female representation generally, the Committee will receive annual progress reports along with improved reporting of diversity analytics across the Group.

Further information on gender diversity, including the proportions of women in senior management and within the organisation overall, is contained in the Corporate responsibility report on pages 24 to 27.

**Succession planning**
During the year, the Committee reviewed succession plans for the Board and the Group Executive, together with the development plan for key individuals identified as potential successors. In addition, the Committee was mindful of the length of service and anticipated retirement dates for Dennis Millard, Anthony Cann and John Worby, each of whom will have served as directors for nine years in August 2015. In preparation for their expected retirements, the Committee undertook an evaluation during the year of non-executive director succession. In line with its usual procedure, having evaluated the composition of the Board and its Committees and the required balance of skills, knowledge, experience and diversity, including gender, it prepared descriptions of the roles and capabilities required. MWM Consulting, a leading external search agency, has been appointed to assist in progressing the Board's succession plans with the aim of appointing a successor to the Chairman as a first step and by no later than the AGM in early 2016 recruiting further candidates as part of the Board refresh. The Committee confirms that MWM Consulting has no other connection with the Company, that all selection decisions are based on merit and that all recruitment activities are fair and non-discriminatory.

**Approval**
This report was approved by the Nominations Committee and signed on its behalf by:

**Dennis Millard**
Chairman of the Nominations Committee
15 October 2014

# Nominations Committee report

**Membership**
Dennis Millard (Chairman)
Andrew Brent
Anthony Cann
John Worby

The Nominations Committee is chaired by Dennis Millard, who is Chairman of the Board. The other members of the Committee are Andrew Brent, Anthony Cann and John Worby, who are all independent non-executive directors.

**Role and responsibilities**
The role and responsibilities of the Committee are set out in its terms of reference, which are available on the Company's website, www.connectgroupplc.com, and from the Company Secretary on request. The terms of reference are reviewed annually by the Committee and then referred to the Board for approval. The principal responsibilities of the Committee are:
- reviewing the structure, size and composition of the Board including the skills, knowledge, experience and diversity of the directors;
- ensuring plans are in place for orderly succession planning for directors and senior management; and
- identifying and nominating candidates to fill Board vacancies.

**Meetings**
The Committee met once during the year and has met once since 31 August 2014. Both meetings were attended by all Committee members. The Group Chief Executive and Group Human Resources Director having been invited by the Committee, also attended the meetings.

**Activities during the year**
In the year ended 31 August 2014 and up to the date of this report the Committee has reviewed and approved:
- the Board and Group Executive succession plans, with feedback on specific individuals being incorporated into their development plans;
- the composition of the Group Executive in line with the new divisional and management structure;
- the Group-wide diversity analytics;
- the Group's Statement of Ambition in relation to diversity and inclusion to be considered in the context of Board recruitment plans;
- the identification and review of the future talent pipeline;
- its own effectiveness;
- the outcome and expressions of opinion from the Board evaluation in relation to non-executive director succession planning and the skills, expertise and knowledge which might enhance the Board's performance; and
- its terms of reference.

There were no new appointments to the Board during the year.

**Diversity and inclusion**
The Committee recognises the benefits of diverse skill sets, capabilities, backgrounds and experience to the effective functioning of the Board and the achievement of the Group's objectives and longer-term strategy. Accordingly, the Board has approved a Statement of Ambition in relation to diversity and inclusion in its broadest sense, encompassing gender, experience and background. The Statement of Ambition sets out the Group's aspiration to increase female representation at manager level and above, whilst continuing to ensure that all candidates are selected on merit against objective criteria rather than to meet specific quotas.

The Board considers itself diverse in terms of the background, skills and experience each director brings to the Board. However, it is mindful that there are currently no female members on the Board (FY2012/13: 0%). As such, the Committee has set an aspiration to increase female representation on the Board to 25% by targeting the recruitment of female Board members through executive search partners who are signed up to the voluntary Code of Conduct on gender diversity, developed in response to the Davies Report. Accordingly in the recruitment process currently underway for the Chairman, and in light of the forthcoming retirements of Anthony Cann and John Worby, we will encourage our recruitment partners to present more balanced candidate recommendations with at least one credible and qualified female candidate provided within the shortlist.

The Board is also mindful that:
- there is 13% (FY2012/13: 25%) female representation on the Group Executive Board; and
- excluding those Managing Directors who are also members of the Group Executive Board, the female representation on the divisional Executive Boards is:
  - 50% (FY2012/13: 50%) on the Connect News & Media Executive Board;
  - 17% (FY2012/13: 20%) on the Connect Education & Care Executive Board; and
  - 13% (FY2012/13: 20%) on the Connect Books Executive Board,

and it is intended to adopt the approach outlined above to facilitate an increase in female representation on the Group and divisional Executive Boards.

# Audit Committee report continued

every five years. The Committee is mindful of the EU reform of the audit market. Having undertaken an audit tender in 2013, the Committee believes that it should await clarification of the UK Government's plans for mandatory audit rotation before deciding on when a further audit tender would be appropriate.

To assess the effectiveness of the external auditor, each member of the Committee, the Chief Financial Officer, the Head of Group Finance and divisional finance directors completed an extensive questionnaire covering matters such as the external auditor's processes for internal review of accounting judgments, including understanding of the key issues; the expertise and technical knowledge within the external audit teams to audit effectively the Company; the scope, delivery and execution of the audit plan; and the robustness and perceptiveness of the external auditor. The findings were reviewed by the Committee, which concluded that the external audit process had been effective. Areas identified for improvement were communicated to Deloitte for action.

During the year, the Committee updated the formal policy on the Company's relationship with the external auditor, which includes financial approval limits for non-audit services and restrictions on the nature of work that can be performed to ensure that the external auditor's objectivity is not impaired. The prior approval of the Chairman of the Audit Committee is required if the cost of non-audit work is likely to exceed £20,000 per annum or where the maximum combined Group spend is likely to exceed 70% of the annual audit fee for the financial year. Deloitte are retained as the Company's independent remuneration adviser and the Committee is satisfied that Deloitte has adequate safeguards in place, including separate engagement teams led by separate engagement partners, to ensure that its independence is not impaired. However, the Remuneration Committee is mindful of the length of tenure of Deloitte as remuneration advisers and the fact that Deloitte are also the Company's auditors and intends to conduct a review of remuneration services in the next 12 months. The fees paid to Deloitte during the year in respect of audit and non-audit services are shown in Note 3 to the Accounts.

The Committee is satisfied that Deloitte continue to provide an effective audit service and has recommended to the Board that they be reappointed. Accordingly, a resolution to reappoint Deloitte will be put to shareholders at the AGM.

**Internal Audit function**

The Committee is responsible for monitoring and reviewing the effectiveness of the internal audit function in the context of the Group's overall risk management system. The Company's Head of Internal Audit is responsible for the overall management of internal audit.

In fulfilling its responsibilities, the Committee has reviewed the following in the period:

- the scope, resource and activities of the internal audit function following which the Committee approved an increase in resource for the year ahead;
- Internal Audit's plans and its achievement of the planned activity;
- a summary of the reports on the results of individual audit reviews, significant findings, management action plans, and timeliness of resolution; and
- the performance of the internal auditors.

**Whistleblowing, bribery and fraud**

During the year the Committee reviewed the arrangements by which incidences of suspected fraud, bribery or other malpractices can be reported and separately approved an updated Whistleblowing Policy and supporting procedure, which sets out clear notification, investigation and escalation processes. The Group operates a telephone hotline whereby employees can report in confidence suspected incidences of fraud, bribery or non-compliance with Group policies and practices. All such incidences are investigated by Internal Audit and/or management and reported to the respective business's Internal Risk Committee and the Audit Committee. On completion of an investigation findings are reported to the appropriate Internal Risk Committee and the Audit Committee.

**Overview**

In carrying out the activities outlined above, the Committee has acted in accordance with its terms of reference. It has also ensured the independence and objectivity of the external auditor, and has assisted the Board in its review of the Annual Report and Accounts 2014, including the effectiveness of the Group's system of internal control and risk management.

The Chairman of the Audit Committee will be available at the AGM to answer any questions about the work of the Committee.

**Approval**

This report was approved by the Audit Committee and signed on its behalf by:

**John Worby**
Chairman of the Audit Committee
15 October 2014

Committee agreed with the proposal to reduce the amortisation period of the remaining Blackwell's intangibles from 10 to 7.5 years.

Property contracts – Management's estimation of the exposure to operating and contingent leases and the resultant provisions required were reviewed and the Committee agreed that the provisions held were reasonable in the circumstances. As a result, £0.5m of prior year provisions were released in the year as a non-recurring item. The Committee agreed with this treatment recognising the original provision related to non-trading properties and the release was consistent with the manner in which the original provisions had been made.

Taxation – The Committee reviewed papers explaining the tax charge for the year, including the credit in relation to prior year tax and tax provisions held at 31 August 2014. The Committee was satisfied that the Group has adequately provided for known tax risks (both UK and overseas) and the tax charge for the year which had resulted in an underlying effective tax rate of 18.7% (FY2012/13: 23.0%) was reasonable.

Retirement benefit obligation – As explained in Note 1 to the Accounts, the accounting treatment of pension interest had been amended in accordance with IAS19 (Revised). The Committee reviewed the quantum and presentation of the resultant prior year adjustment. It also reviewed the reasonableness of the actuarial assumptions underlying the retirement benefit obligation at 31 August 2014 and satisfied itself that the amount and treatment of the obligation was reasonable and complied with the requirements of IAS19 and IFRIC14.

Inventories and trade receivables – The carrying value of inventories and trade receivables at 31 August 2014 was £45.3m and £107.9m respectively (FY2012/13: £44.2m and £107.6m). The Committee reviewed the reasonableness of management estimates of carrying value, paying increased attention to slow moving inventory and the ageing and recoverability of receivables in Connect Books. In the light of its review, the Committee was satisfied that the provisions for slow moving inventory and doubtful receivables were reasonably stated.

Non-recurring and other items – The Committee considered the appropriateness of the measure of adjusted profits and the classification and transparency of items separately disclosed as non-recurring and other items. It was satisfied that the measure of adjusted profits provided a reasonable view of underlying performance of the Group and that there was transparent disclosure of the measure and of items shown separately as non-recurring and other items.

Revenue recognition – That the Group has appropriately recognised revenues in accordance with their contractual obligation during the period, paying attention to expected returns.

The Committee also reviewed the paper prepared by management to support the Going Concern assumption referred to on page 23 of the Annual Report and concurred that the profit and cash forecasts supported the view that the Group can operate within the level of its current financing for the foreseeable future.

The Committee reviewed the content of the Interim Financial Report for the half year to 28 February 2014 and, at the request of the Board, reviewed the Annual Report and Accounts for the year to 31 August 2014, to ensure that it included the necessary information to provide shareholders with a fair and balanced assessment of the Company's performance, business model and strategy. It was satisfied that, taken as a whole, the Annual Report is fair, balanced and understandable. This assessment was supported by the following preparation and review process:

- Initial guidance on key themes, focus and balance of the Annual Report provided to Group-level contributors;
- Operational submissions collated and consolidated by the executive team who review the appropriate fair and balanced reflection of the business as a whole;
- Regular review meetings during the preparation of the Annual Report with Group-level contributors to ensure consistency throughout the whole Report;
- Verification process undertaken to ensure that all factual information is supported and accurate;
- Drafts reviewed by the Committee prior to consideration by the Board; and
- Review by the Audit Committee of a paper prepared by the Chief Financial Officer outlining the work undertaken and the key judgments made in concluding that the Annual Report is fair, balanced and understandable.

**Internal control and risk management**

The Audit Committee is responsible for keeping under review the effectiveness of the Company's risk management and internal control systems.

During the year, the Committee received updates from Internal Audit on the key risks facing the Group, as set out in risk maps and various legal and regulatory risk reports. Executives responsible for key risk areas across the Group periodically present to the Audit Committee their plans to monitor and control the key risks. During the year, this included presentations and discussion on cyber security and business continuity planning.

The Committee reviewed progress against the agreed annual internal audit plan and reports on individual internal audit reviews completed in the year. Progress on actions to address control risks highlighted from such internal audit reviews were also monitored. Control weaknesses were identified across the Books division in relation to management of key projects, approval of new commercial contracts and timely matching in accounts receivable balances. Compensating controls have been identified and implemented to mitigate the risk of these control weaknesses by the year end and an action plan to improve controls is being implemented by management. The Head of Internal Audit also updated the Committee on the effectiveness of the Company's internal controls.

As a result of this work, the Committee reported to the Board that, in the context of the Group taken as a whole, it was not aware of any significant deficiencies or material weakness in the Company's systems of internal control.

During the year the Committee also received and reviewed reports on the Company's treasury, taxation and IT security activities and related policies.

**External auditor**

Under its terms of reference, the Committee is responsible for assessing the scope, fee, objectivity and effectiveness of external audits, and for making a recommendation to the Board regarding the appointment, reappointment or removal of the external auditor on an annual basis.

As explained in last year's report, a tender for external audit services was held in 2013 and following a robust tender process, the Committee recommended the reappointment of Deloitte LLP ('Deloitte'). Deloitte's original term of engagement is regarded as having commenced on 31 August 2006, being the date of demerger of old WH Smith PLC and, in line with professional standards, it has a policy of rotating partners

# Audit Committee report

**Membership**
John Worby (Chairman)
Andrew Brent
Anthony Cann
Dennis Millard

The Audit Committee is chaired by John Worby. All the members of the Audit Committee are independent non-executive directors, with the exception of Dennis Millard, who is Chairman of the Board. As permitted by the UK Corporate Governance Code (as the Company is outside of the FTSE 350), Dennis Millard is a member of the Committee. In the light of his extensive financial experience, the Board believes that he makes a valuable contribution to the Committee and does not consider that his independence presents any issue or concern.

John Worby, who is a member of the Financial Reporting Review Panel, and until March 2013 was the Group Finance Director of Genus plc, is considered by the Board to have recent and relevant experience to chair the Committee. Each of the other members of the Committee has extensive business experience.

**Role and responsibilities**
The role and responsibilities of the Committee are set out in its terms of reference, which are available on the Company's website, www.connectgroupplc.com, and from the Company Secretary on request. The terms of reference, which address all matters set out in Disclosure and Transparency Rule 7.1 and the UK Corporate Governance Code, are reviewed annually by the Committee and then referred to the Board for approval. The principal responsibilities of the Committee are:
- monitoring the integrity of the Group's financial statements and any other announcements relating to the Group's financial performance and reviewing significant financial reporting issues and judgments contained therein;
- reviewing the content of the Annual Report and Accounts and advising the Board whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy;
- keeping under review the effectiveness of the Group's internal control and risk management systems;
- monitoring and reviewing the effectiveness of the Group's internal audit function in the context of the Group's overall risk management system;
- considering and making recommendations to the Board as to the appointment, reappointment or removal of the external auditor and the approval of their remuneration and terms of engagement;
- assessing the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- reviewing the policy on the engagement of the external auditor to supply non-audit services, taking into account relevant professional and regulatory guidance and monitoring compliance;
- ensuring the Company maintains suitable arrangements for employees to raise matters of concern in confidence ('whistleblowing'); and
- reviewing the Group's regulatory compliance framework and the systems and controls for the prevention of fraud and bribery.

The Committee identifies any matters in respect of which it considers that action or improvement is needed, and makes recommendations as to the steps to be taken.

**Meetings**
The Committee met four times during the year to consider an agenda planned around the Group's financial calendar. All Committee members were in attendance at each of the meetings.

At the invitation of the Committee, the Group Chief Executive, Chief Financial Officer, Managing Director Connect News & Media, Group Head of Internal Audit and representatives of the external auditor attend its meetings. Other members of the executive management and Group functional teams also attend meetings from time to time to present reports specific to their areas of responsibility.

The Committee met twice with the external auditor without management present and held a separate private meeting with the Group Head of Internal Audit.

The Committee has met once since 31 August 2014.

**Activities during the year**
Detailed below is an overview of the key areas considered by the Committee during the year ended 31 August 2014 and up to the date of this report.

**Financial reporting**
During the year the Committee reviewed reports from the Chief Financial Officer and the external auditor on matters of significance in relation to the financial statements for the half year and the full year to 31 August 2014; this included consideration of the key estimates and judgments made in preparing the financial statements.

The significant issues and key judgments considered by the Committee in relation to the 2014 financial statements included the following:

Business combinations and goodwill – The Committee considered the carrying value of intangible assets and goodwill in relation to acquisitions including whether there has been any impairment in the carrying value of such assets. In the light of the poor performance of Connect Books, specific consideration was given to the carrying value of Connect Books goodwill and to the carrying value and amortisation of acquired intangibles relating to the acquisition of contracts from Blackwell UK Limited. Whilst the headroom in Connect Books between the recoverable amount and the carrying value of goodwill has reduced, the Committee noted that the assumptions regarding the future performance of the business appeared to be reasonable and sensitivity modelling still resulted in headroom above the carry value. As a result it concurred with there being no impairment required at 31 August 2014, other than in respect of the intangibles relating to Blackwell contracts, where management had proposed a write off of £0.5m. In addition, the

- an Anti-Corruption Policy which is reviewed annually by the Board;
- a Health and Safety Policy, which is reviewed annually by the Board;
- Health and Safety Risk Management teams, working with the businesses to assess health and safety risks and introduce systems to mitigate them. Details of major business incidents are reported to the Internal Risk Committees and the Audit Committee, and all notified accidents are investigated;
- reports on Health & Safety matters including the Reporting of Injuries, Diseases and Dangerous Occurrence Regulations provided to the Board on a regular basis;
- a commitment by the Company to ensure that its personnel meet high standards of integrity and competence. The Company's systems cover recruitment, training and development of personnel, and the communication of Company policies and procedures throughout the organisation;
- business recovery plans to enable each of the Group's businesses to continue with minimum disruption to customers in the event of a disaster. These plans are reviewed by the respective business Internal Risk Committee and the Audit Committee;
- an IT Security Policy to protect the Company, its employees and affiliates from illegal or damaging actions by third parties;
- a Code of Business Conduct which takes into account the interests of all stakeholders;
- a Whistleblowing Policy and associated speak up line whereby employees can report in confidence incidences of suspected fraud; and
- a Data Protection Policy setting strict guidelines for the use of confidential customer and supplier data.

The Internal Audit team assists in maintaining adequate financial controls by reviewing the design and operating effectiveness of core financial processes and controls as part of the internal audit plan approved by the Audit Committee annually.

Internal Audit annually discusses the effectiveness of internal controls with all senior executives from across the Group in order to co-ordinate formal certifications in respect of the effectiveness of those internal controls. These certificates are made available to the Audit Committee in order to assist the Board with conducting its annual review of the effectiveness of internal controls in compliance with the Revised Guidance for Directors on Internal Control.

The Audit Committee has carried out a review of the effectiveness of the Company's systems of risk management and internal control during the year. This assessment considered all significant aspects of risk management and internal control arising during the period covered by this report including the work of internal audit. During the course of this review, the Audit Committee has not identified nor been advised of any failings or weaknesses which it has determined to be significant in the context of the Group taken as a whole.

**Annual Report and Accounts 2014**

During the year, the Board requested the Audit Committee to undertake a review of the Annual Report and Accounts 2014 to ensure that, taken as a whole, it provided shareholders with a fair, balanced and understandable assessment of the Company's performance, business model and strategy. Following recommendation by the Audit Committee and discussion by the Board, the directors confirm that they consider that the Annual Report and Accounts 2014 is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, position and prospects.

**Relations with shareholders**

The Board is responsible for and recognises the importance of communicating with the Company's shareholders to ensure that both strategy and performance are understood. This is achieved principally through the Company's website, www.connectgroupplc.com, and the AGM. The website, which was redesigned during the year to improve user experience and access, provides investors with a wide range of information about the Company, including Annual Reports, regulatory news releases, share price data and the Company's financial calendar, and incorporates a Shareholder Centre containing AGM and other useful information.

Following the announcement of the Company's full year and interim results, formal presentations are made to institutional shareholders by the Group Chief Executive and Chief Financial Officer covering a range of key issues affecting the Company's performance. The presentations are available to view on the Company's website at www.connectgroupplc.com.

All shareholders have the opportunity to ask questions at the AGM, which is normally attended by all of the directors. The notice of the AGM is sent to shareholders at least 20 working days before the meeting and includes notice of the availability of the Annual Report and Accounts on the Company's website. At the AGM, separate resolutions are proposed on each separate issue and shareholders vote on each resolution by way of a poll (rather than on a show of hands). This ensures that the final result is more democratic as the proxy votes are added to the votes of shareholders present, who vote all their shares (rather than one vote per shareholder). Proxy Forms allow shareholders to vote for or against, or to withhold their vote on each resolution, and the results of the poll are announced to the London Stock Exchange and published on the Company's website.

The Board as a whole is kept fully informed of the views and concerns of major shareholders. The Group Chief Executive and Chief Financial Officer update the Board following meetings with major shareholders whilst independent feedback from shareholders is provided to the Board by the Company's advisers and brokers. The Chairman met with certain institutional shareholders during the year and both he and the senior independent director make themselves available to attend meetings with major shareholders.

**Approval**

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

**Dennis Millard**
Chairman
15 October 2014

# Corporate governance continued

### Attendance at Board and committee meetings

The following table shows the attendance of directors at Board and committee meetings held during the year.

| | Scheduled Board meetings | Additional Board meetings[1] | Committee Meetings Audit | Nominations | Remuneration |
|---|---|---|---|---|---|
| **No. of meetings** | **8** | **6** | **4** | **1** | **4** |
| Dennis Millard | 8 | 6 | 4 | 1 | 4 |
| Jonathan Bunting | 8 | 6 | – | – | – |
| Mark Cashmore | 8 | 6 | – | – | – |
| Nick Gresham | 8 | 6 | – | – | – |
| Andrew Brent | 8 | 6 | 4 | 1 | 4 |
| Anthony Cann | 8 | 6 | 4 | 1 | 4 |
| John Worby | 8 | 6 | 4 | 1 | 4 |

1 Four of the six additional Board meetings held during the year were held by telephone conference call, at which all of the directors were in attendance.

The Board has met three times since 31 August 2014 which included one dedicated off-site business planning and strategy day, at which all of the directors were in attendance. The Board has held one conference call since 31 August 2014, at which all of the directors, with the exception of Andrew Brent, were in attendance. In addition, the Audit Committee and Nominations Committee have met once and the Remuneration Committee has met twice since 31 August 2014.

### Board effectiveness

The Board has a formal process for evaluating its effectiveness, the effectiveness of its committees and of individual directors. An external review of the Board's effectiveness was conducted by OE Cam in 2012 and the Board intends to undertake an externally facilitated review every three years.

Accordingly, this year the Board adopted an internal evaluation process which took place between July and September and consisted of: each director completing an extensive questionnaire covering Board and committee procedures and effectiveness, Board balance and diversity and individual contributions to Board and committee meetings; a one-to-one discussion between the Chairman and each director to discuss their contribution and performance during the year and training needs, if any; and a meeting of the non-executive directors led by the senior independent director to discuss the Chairman's performance and provide feedback.

The responses to the questionnaire were considered by the Board at its September meeting. Whilst noting the disappointing performance of Connect Books, the evaluation confirmed the conclusion drawn from the previous evaluation that the Board generally operated effectively, robustly and with mutual respect. There were a number of actions that were agreed to ensure that the Board, its committees and individual directors continue to work effectively, including: the reordering of Board meeting agendas to prioritise specific items for Board consideration; further improving the quality, succinctness and timeliness of Board reporting; ensuring the Board receives timely information on key factors affecting business performance; continuing to strengthen the robustness of Board challenge; and, addressing diversity as part of the Board's succession plans.

### Internal control and risk management

The Board has overall responsibility for the Group's system of internal control including risk management and for reviewing its effectiveness. Such a system is designed to manage or mitigate rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Group has an established framework of internal controls covering both financial and non-financial controls. In addition, there is an ongoing process for identifying, evaluating and managing significant business risks faced by the Group, including those risks relating to social, environmental and ethical matters. This process was in place throughout the year under review and up to the date of approval of this report and accords with the Revised Guidance for Directors on Internal Control (formerly called Turnbull Guidance). Further details of the Group's risk management framework, along with the Group's principal risks are set out in the Strategic Report on pages 8 to 9.

The Board is responsible for the overall strategic direction and management of the Group. Full details of the Board's responsibilities are set out in the formal schedule of matters reserved for its decision, which are summarised on page 33.

The Approvals Committee, which comprises the Group Chief Executive and Chief Financial Officer, and for commercial transactions the relevant member of the executive management, is authorised by the Board to approve routine matters within agreed financial limits.

The Board has established an organisational structure with clearly defined reporting lines and controls at all levels of management across the Group, identifying transactions requiring approval by the Board or by the Approvals Committee.

The Audit Committee assists the Board in the discharge of its duties regarding the Group's financial statements, accounting policies and the maintenance of proper systems of risk management and internal control.

The system of financial control also includes:
- a comprehensive system of budgeting and planning together with monitoring and reporting the performance of the Group's businesses to the Board. Monthly results are reported against budget and prior year, and forecasts for the current financial year are regularly revised in the light of actual performance. These cover profits, cash flows, capital expenditure and balance sheets;
- a full appraisal of all major investment projects;
- key controls over major business risks including reviews against performance indicators and exception reporting;
- monthly reporting of treasury activities and risks, for review by senior executives; and
- annual reports covering treasury policy, pensions and insurance, for review by the Board or Audit Committee.

Additional non-financial controls include:
- key performance indicators to monitor customer service levels in each business;
- independent customer satisfaction surveys;
- independent employee relations surveys;
- a corporate responsibility programme which addresses the impact of the Company's activities on the environment, workplace, marketplace and community;
- a Corporate Responsibility Committee which is responsible for reviewing delivery against corporate responsibility objectives, with annual updates provided to the Board;
- an Environmental Policy, which is reviewed annually by the Board;

## The Board

### Board composition

On 15 October 2014, the Board comprised the Chairman, three executive directors and three independent non-executive directors. Short biographies of each of the directors, which illustrate their range of experience and qualifications, are set out on pages 28 and 29.

There is a clear division of responsibility at the head of the Company; Dennis Millard (Chairman) being responsible for running the Board and Mark Cashmore (Group Chief Executive) being responsible for managing the Group's businesses and implementing Group strategy. The division of responsibilities between the Chairman and Group Chief Executive has been set out in writing and agreed by the Board. The Board considers that it is of an appropriate size to oversee the Group's businesses, with a structure that ensures that no individual or group dominates the decision-making process.

Dennis Millard, who was non-executive Deputy Chairman until his appointment as Chairman on 6 February 2008, met the independence criteria set out in the Code on appointment as Chairman. Andrew Brent, Anthony Cann and John Worby (senior independent director), who served as non-executive directors throughout the year and up to the date of this report, meet the independence criteria set out in the Code. In determining the independence of the non-executive directors, the Board has due regard to the directorship tenure. In light of the expected retirements from the Board of Dennis Millard, Anthony Cann and John Worby as they approach nine years' service in August 2015, during the year the Nominations Committee undertook a review of the skills, experience and diversity required on the Board and has appointed MWM Consulting, a leading external search agency, to assist in progressing its Chairman and non-executive director succession plans; further information regarding Board succession planning can be found in the Nominations Committee report on pages 39 and 40.

### Role of the Board

The Board is responsible for the overall strategy and performance of the Group, and had eight scheduled meetings and six additional meetings during the year. It manages the Company through a formal schedule of matters reserved for its decision. Such matters include:

- overall strategic direction and management of the Group, including acquisitions and disposals;
- approval of long-term objectives and commercial strategy;
- approval of the annual operating and capital expenditure budgets;
- approval of major capital expenditure;
- approval of material agreements and non-recurring projects;
- changes relating to the Company's capital structure;
- approval of the accounts;
- dividend and treasury policies;
- control, audit and risk management;
- remuneration of directors and senior managers; and
- corporate responsibility.

The Schedule of Matters Reserved for the Board is available on the Company's website, www.connectgroupplc.com, and from the Company Secretary on request.

Board meetings are structured to facilitate the fulfilment of the Board's responsibilities; this is achieved by way of an annual agenda planner which is reviewed and updated at each Board meeting. In preparation for meetings, supporting papers are circulated in a timely manner and of a quality sufficient for the Board to take decisions. The Board receives regular updates on matters such as strategy, financial and management reporting, investor relations and corporate governance, in addition to non-recurring matters for consideration such as acquisitions and material transactions.

### Directors

All new directors receive induction training on joining the Board, which is tailored to meet the needs of the individual. The induction programme is supplemented by ongoing training and development, the need for which is regularly assessed by the Board. Resources available to the directors include:

- membership of the Deloitte Academy, a training and guidance resource for boards and directors;
- a programme of head office and business visits;
- separate presentations by business and functional teams;
- annual reviews with the Chairman to identify any training and development needs;
- advice and regular updates from the Company Secretary on governance, regulatory and legislative changes affecting the business and their duties as a director; and
- access to independent professional advice at the Company's expense.

The Company's Articles of Association (the 'Articles') require that directors offer themselves for re-election every three years and that new directors appointed by the Board offer themselves for election at the next Annual General Meeting following their appointment. However, the Board has agreed that all directors will stand for re-election at the Annual General Meeting ('AGM') on 4 February 2015. This practice was introduced in 2011 and accords with the Code (notwithstanding that the Company, which is a 'smaller company' for the purposes of the Code, is not formally required to re-elect all directors on an annual basis).

The Board is satisfied that the Chairman and all of the non-executive directors have sufficient time available to contribute external expertise and experience in areas of importance to the Group, and in so doing make an effective and valuable contribution to the Board.

Details of the directors' service contracts, remuneration, share interests and shareholdings in the Company are shown in the Directors' remuneration report on pages 41 to 57.

### Directors' conflicts of interest

The Companies Act 2006 provides that a director must avoid situations where he can have a direct or indirect interest that conflicts or might conflict with the interests of the Company ('situational conflicts'). The Company's Articles contain provisions that allow the Board to consider and, if it sees fit, to authorise situational conflicts.

The Board confirms that a formal system for directors to declare their interests and for the independent directors to authorise situational conflicts continues to be in place. Any authorisations given are recorded in the Board minutes and in a register of directors' conflicts which is reviewed annually by the Board.

### Board committees

The Board delegates specific responsibilities to its Audit, Nominations, Remuneration and Approvals Committees, each with its own formal terms of reference which are reviewed annually and then referred to the Board for approval.

Details of the Audit, Nominations and Remuneration Committees, including their role and responsibilities, can be found in the Audit Committee report on pages 36 to 38, the Nominations Committee report on page 39 and 40 and the Directors' remuneration report on pages 41 to 57.

The terms of reference for each of the committees have been updated during the year and are available on the Company's website, www.connectgroupplc.com, and from the Company Secretary on request.

# Corporate governance

**The following section of the Annual Report and Accounts, together with the Audit Committee report on pages 36 to 38, the Nominations Committee report on pages 39 and 40 and the Directors' remuneration report on pages 41 to 57, describes how the Company has applied the main principles contained within the UK Corporate Governance Code 2012 (the 'Code'). The Code, which sets out the principal governance rules which apply to UK companies listed on the London Stock Exchange, is publicly available at www.frc.org.uk.**

### Statement of compliance with the Code

The Company confirms that throughout the year ended 31 August 2014, it has been compliant with the provisions of the Code.

### Governance framework

The Group operates within a clear governance framework, which is outlined in the diagram below and set out in this report. The Group's risk management framework along with the Group's principal risks are described in the Strategic Report on pages 8 to 9.

**Chairman**
Dennis Millard

**Group Board**
Seven directors: the Chairman, three executive directors and three independent non-executive directors (including the senior independent director)

| Audit Committee | Nominations Committee | Remuneration Committee | Approvals Committee |
|---|---|---|---|
| The Chairman and the three independent non-executive directors | The Chairman and the three independent non-executive directors | The Chairman and the three independent non-executive directors | two standing members, the Group Chief Executive and Chief Financial Officer plus (for operating company transactions) the relevant Executive member |

**Group Chief Executive**
Mark Cashmore

**Group Executive**
Eight members comprising the executive directors (Group Chief Executive, Chief Financial Officer and Managing director of Connect News & Media), the Managing directors of Connect Books and Connect Education & Care, the Group Human Resources director, Group IT & Services director and Group Strategy director

### Reporting requirements table

| Reporting requirement | Location |
|---|---|
| Description of the Group's strategy and business model. | Strategic Report<br>See pages 4 and 5 and 10 and 11. |
| Environmental impact, including data on greenhouse gas emissions. | Corporate responsibility report<br>See pages 24 to 27. |
| Employee diversity data and human rights. | Corporate responsibility report<br>See page 24 to 27. |
| Statement that the directors consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy. | Corporate governance and Audit Committee report<br>See pages 35 and 37. |
| Identification of search consultancy used and any connections with the Company. | Corporate governance and Nominations Committee report<br>See pages 33 and 40. |
| Description of the significant issues that the Audit Committee considered in relation to the financial statements and how these issues were addressed, having regard to the matters communicated to it by the external audit team. | Audit Committee report<br>See pages 36 and 37. |
| Explanation of how the Audit Committee has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor to enable shareholders to understand why it recommended reappointing or changing the auditor. | Audit Committee report<br>See pages 37 and 38. |
| Remuneration policy report, including future policy tables and notes; performance scenario charts; and remuneration obligations in service contracts. | Directors' remuneration report<br>See pages 42 to 47. |
| Annual report on remuneration, including: single total figure tables; the link between pay and performance; directors' shareholdings and share interests; Group Chief Executive pay comparison to Company performance; relative importance of spend on pay; remuneration paid to external advisers; and statement of shareholder voting on the 2012/13 remuneration report. | Directors' remuneration report<br>See pages 48 to 57. |

# Corporate governance Introduction by the Chairman

**The Board is committed to promoting the highest standards of corporate governance and, most importantly, embedding these standards consistently across the entire organisation.**

This year, to demonstrate our continued focus on conducting business professionally, fairly and with honesty and integrity, we have introduced the Group's new Values which set out the behaviours expected from our employees (see page 13). We are committed to ensuring that they are part of the daily working practice throughout the organisation.

The effectiveness of the Board is vital in upholding these standards; during the year we evaluated Board effectiveness, the results of which were generally positive and highlighted some areas for improvement as outlined later in the Corporate Governance report. As a Board, we continue to challenge constructively, debate robustly and value the different contributions of our directors, enriching the quality of boardroom discussions.

The Board is mindful of the tenure of the non-executive directors and the benefits of refreshing the experience, skills and diversity present on the Board. In light of this, during the year the Nominations Committee undertook an evaluation of non-executive director succession and commenced a recruitment process, further details of which can be found in the Nominations Committee report on pages 39 to 40.

The Board recognises that diversity in all its forms, be it gender, skill set, cultural background, disability or ethnicity is essential to the achievement of the Group's objectives and longer-term strategy. To encourage diversity, the Board has approved a Statement of Ambition which sets out the Group's approach and aspirations for increasing female representation at both Board level and across the wider workforce.

In order to attract and retain the best candidates, the Remuneration Committee ensures that our remuneration framework is appropriately structured, in a fair and responsible manner. As explained in last year's report, we chose to adopt early certain aspects of the revised directors' remuneration reporting regulations; this year we have restructured our Remuneration Report to comply fully. Accordingly, on pages 42 to 47, the Committee sets out the proposed directors' remuneration policy, which will be subject to a binding shareholders' vote at our 2015 AGM, and on pages 48 to 57 the annual report on remuneration, which will be subject to an advisory vote.

Changes in the regulatory landscape have encouraged us to take a fresh look at our narrative reporting. The Strategic Report provides a clear and concise overview of our strategy, business model, objectives, KPI's and principal risks along with certain new disclosures. The Audit Committee undertook a thorough review of the Annual Report and Accounts to facilitate the Board's view that it provides a fair, balanced and understandable assessment of the Group's performance, position and prospects.

As set out in our Audit Committee report on pages 37 and 38, we undertook a full review and competitive tender of external audit services in 2013 and, after careful consideration, recommended the reappointment of Deloitte LLP. To strengthen further the independence and objectivity of the external auditor, during the year the Audit Committee reviewed and updated the Non-Audit Services Policy. The Audit Committee is also mindful of the developments of the EU reform of the audit market and awaits clarification of the UK Government's plans for mandatory audit rotation before deciding on when a further audit tender would be appropriate.

**Dennis Millard**
Chairman

# Group Executive

**Mark Cashmore**
Group Chief Executive

**Jonathan Bunting**
Managing Director,
Connect News & Media

**Nick Gresham**
Chief Financial Officer

See previous page for biographies.

**Glenn Leech**
Managing director, Connect Education & Care
Aged 39

Glenn Leech joined WH Smith News in 2004 as Human Resources director. Prior to joining WH Smith News, Glenn spent seven years at Ford Motor Company, during which time he held a number of managerial positions in Employee Relations, HR Business Operations and as an HR Project Manager. He was appointed Group Human Resources director on 1 September 2011 and Managing director, The Consortium on 26 October 2013. In April 2014, Glenn became Managing director of the Connect Education & Care division.

**Graeme Underhill**
Managing director,
Connect Books
Aged 56

Graeme Underhill joined WH Smith News in 1975. Graeme managed a number of depots before moving to Head Office in 1997 as Project Manager for the Business Process Review. He held various senior central roles including SAP Project Manager, Operations Development Manager and Operations director before being appointed Managing director, Bertrams in August 2011. In April 2014, Graeme became Managing director of the Connect Books division. Having announced his intention to retire, Graeme will step down as Managing Director, Connect Books at the end of the year.

**Sarah Miles**
Group Human Resources director
Aged 46

Sarah Miles joined the Group in August 2013. Prior to joining, Sarah led the Chartered Institute of Personnel and Development's expansion into Asia. Prior to that, she spent 12 years at PepsiCo in a variety of HR leadership roles, most recently as Senior HR Director of PepsiCo's UK Manufacturing & Logistics divisions where she also had HR responsibility for Finance, IT and Special Projects. Before joining PepsiCo she worked for Pearson and Marks and Spencer.

**Max Livingstone-Learmonth**
Group Strategy director
Aged 37

Max Livingstone-Learmonth joined the Group in March 2011 as Head of Corporate Development. Max has 15 years of strategy and corporate acquisitions experience and prior to joining the Group was a director at Price Waterhouse Coopers. He was appointed Group Strategy director and joined the Group Executive on 1 September 2014.

**Richard Webb**
Group IT & Services director
Aged 49

Richard Webb joined WH Smith News as a graduate recruit in 1987. Richard worked in a variety of roles at warehouse locations and regional level before moving to Head Office in 1994 to join the Information Systems Department. He was appointed Information Systems director in 2004 and Group Information Technology director on 1 September 2011, assuming responsibility for Group Services on 1 May 2013.

**John Worby**
Senior independent non-executive director
Aged 63

31 August 2006

John Worby joined the Board on 31 August 2006 and is the senior independent director. He retired as Group finance director of Genus plc in March 2013, having previously been Group finance director and Deputy Chairman of Uniq plc (formerly Unigate plc). He is a non-executive director and Chairman of the Audit Committee of Fidessa Group plc and a member of the Financial Reporting Review Panel.

**Mark Cashmore**
Group Chief Executive
Aged 54

31 August 2006

Mark Cashmore joined the Board on 31 August 2006 as Group Chief Executive. He started his career with Pernod Ricard before moving to United News and Media in 1989. Between 1989 and 1999 he held senior positions in a number of news distribution businesses, including Sales Director of United Magazine Distribution, USM and Seymour. He joined WH Smith News in 1999 and was appointed Magazine Sales director in 2001 and managing director in June 2006.

**Jonathan Bunting**
Managing director, Connect News & Media
Aged 42

1 April 2010

Jonathan Bunting joined the Board on 1 April 2010. He joined WH Smith News as a graduate recruit in 1994. He rose through the organisation in a variety of sales and marketing managerial roles before being promoted to the executive management team in 2001 as Trade Marketing director. He was appointed Commercial director in August 2006, Chief Commercial Officer in April 2010 and managing director, Smiths News on 1 May 2012. In April 2014, Jonathan became managing director of the Connect News & Media division.

**Nick Gresham**
Chief Financial Officer
Aged 43

1 August 2010

Nick Gresham joined the Group and was appointed to the Board on 1 August 2010. Prior to joining, he held various senior financial roles in GUS plc and Home Retail Group plc over a ten-year period, including Group Financial Controller, Finance Director of the Financial Services division and Finance director of Homebase. Before joining GUS Nick worked for Virgin Retail and Debenhams.

**Stuart Marriner**
Company Secretary & General Counsel

**Board Committees**

**Audit Committee**
John Worby, Chairman
Andrew Brent
Anthony Cann
Dennis Millard

**Nominations Committee**
Dennis Millard, Chairman
Andrew Brent
Anthony Cann
John Worby

**Remuneration Committee**
Anthony Cann, Chairman
Andrew Brent
Dennis Millard
John Worby

# Board of Directors

| | **Dennis Millard**<br>Chairman<br>Aged 65 | **Andrew Brent**<br>Independent<br>non-executive director<br>Aged 55 | **Anthony Cann**<br>Independent<br>non-executive director<br>Aged 67 |
|---|---|---|---|
| **Date of appointment** | 31 August 2006 | 1 September 2008 | 31 August 2006 |
| **Background and experience** | Dennis Millard joined the Board as a non-executive director and Deputy Chairman on 31 August 2006 and became Chairman on 6 February 2008. He is non-executive Chairman of Halfords Group plc, non-executive Deputy Chairman of Pets at Home Group Plc and a non-executive director and senior independent director of Debenhams plc and Premier Farnell plc. He was finance director of Cookson Group plc from 1996 to 2005 and was a non-executive director of Exel plc from 2003 until 2005 and Xchanging plc from 2005 until 2012. He is Chairman of Trustees of the charity The Holy Cross Children's Trust. | Andrew Brent joined the Board on 1 September 2008. He was most recently Chief Customer and Marketing Officer at Barclays Bank and prior to that held senior marketing positions in a number of leading companies including BSkyB, Alliance Boots Plc, Burger King Inc., Iceland Frozen Foods Plc and Proctor and Gamble Inc. | Anthony Cann joined the Board on 31 August 2006. He is a solicitor, now non-practising, and was the worldwide Senior Partner of Linklaters, an international law firm, from 2001 until 2006. He is currently a non-executive director of Panmure Gordon & Co. plc, a Trustee of The Social Investment Business Foundation, a director of The Social Investment Business Ltd and Chairman of the Governors of Haberdashers' Adams' Federation Trust. |

'I am absolutely delighted that Connect Group PLC has shown its continuing commitment to educating children by agreeing this new two-year partnership. We wouldn't be able to run the programme without The Consortium providing us with equipment and staff as weekly volunteers.'

**Vicky Heslop, Education Manager, Bath Rugby**

# Stickability – making a difference to schools in the South West

Connect Group has been working with the Bath Rugby Foundation to promote and improve literacy skills in primary schools across the South West. Based on a special sticker-reward system, the Stickability programme combines classroom sessions with outdoor activities, motivating the children and demonstrating that learning and literacy is both fun and rewarding.

Over the last two years we've delivered the six week programme to 19 schools, reaching 738 children, targeting those areas of greatest educational and social need. So far 50 volunteers have supported the delivery of the programme; our Education & Care division works especially closely with the Foundation but staff volunteers have come from across the Group. The programme is led by a full time literacy specialist at the Foundation, and the classroom sessions are further supported by our staff volunteers and guest stars from the famous Bath Rugby team.

Stickability has been so successful that in August 2014 we renewed our sponsorship commitment for a further two years and extended its geographical reach.

# Corporate responsibility continued

## Our workplace

We are committed to supporting our people, offering opportunities to develop skills and providing an environment in which they can grow and enjoy satisfying careers. Our goal is to help every employee flourish in their roles and careers; by doing so we will build a loyal and committed workforce with the expertise to deliver a market leading service.

We believe staff engagement is vital to achieve this. Our Team Talk initiative is an informal staff briefing and feedback programme which ensures everyone has a voice and can contribute constructively to a better workplace. More formally we regularly survey staff for their views on a range of workplace issues, sharing results and working together to address issues and opportunities. Two way communications are encouraged and where appropriate we support major projects and change programmes with staff briefings and confidential online question lines. To allow staff to raise matters of wider concern the Group operates a well-publicised confidential 'speak-up' line.

The Group offers a range of learning and development opportunities for staff, comprising skills training, coaching and professional development. Our online portal encourages self-directed learning and ensures compliance to foundational skills and knowledge such as health and safety awareness. For those with the ambition and talent to make accelerated career progress, we provide bespoke training and on the job development opportunities, including our leadership programmes, graduate and apprentice schemes.

To encourage a wider interest in the performance of the Company, a comprehensive communication programme ensures staff are aware of our strategy, performance and progress to objectives. The Group's Sharesave Scheme is open to all qualifying employees and we communicate regularly on issues affecting employees such as pensions, changes in legislation and employment rights and benefits.

Active policies underpin our approach to responsibility at work. The Group works to ensure a culture that is free from discrimination and harassment in any form. Proper consideration is given to staff and job applicants with disabilities and, should employees develop a disability while working for the Group, every effort is made to continue their employment and provide retraining if required. Our people policies are reviewed on an ongoing basis and the Board takes an active role in reviewing any significant changes and monitoring concerns raised through our confidential whistleblowing procedures.

| 2014 | News & Media | Books | Education & Care | Group Totals |
|---|---|---|---|---|
| Major Injuries | 4 | 0 | 0 | 4 |
| Injuries resulting in over three days absence from work/hospitalisation | 18 | 11 | 4 | 33 |
| All RIDDORs[1] | 22 | 11 | 4 | 37 |

| | 2013 | 2012 | 2011 | 2010 | 2010 LFL[2] | 2009 |
|---|---|---|---|---|---|---|
| Major injuries | 4 | 0 | 2 | 1 | 1 | 2 |
| Injuries resulting in over three days absence from work/hospitalisation | 32 | 45 | 53 | 70 | 43 | 40 |
| All RIDDORs[1] | 36 | 45 | 55 | 71 | 44 | 42 |

1 RIDDOR: Reporting of Injuries, Diseases and Dangerous Occurrences Regulations.
2 LFL: excludes the impact of the new contract areas and depots acquired in 2010 to compare on a like-for-like basis with 2009.

The Group actively supports diversity in the workplace in all its forms and is committed to improving gender composition over time. The current gender composition is:

| | Male | % | Female | % |
|---|---|---|---|---|
| **All employees** | 2,560 | 63.0 | 1,506 | 37.0 |
| **Board of Directors** | 7 | 100.0 | 0 | 0.0 |
| ***Senior managers***[1] | 22 | 78.6 | 6 | 21.4 |

1 Senior managers comprises the Group's Executive Committee and its three divisional executive committees, each of whom has responsibility for planning, directing or controlling the activities of the Company, or a strategically significant part of the Company.

Connect Group is committed to upholding the human rights of our employees and believes that respect, fairness and integrity are an important part of the responsible way we manage our business. These principles are reflected in our Values and are an integral part of each of our HR policies. The Group has in place ethical trading standards that we expect our supply chain partners to adhere to in our trading with them.

## Health & Safety report

The Group maintains the highest standards of Health & Safety, so as to protect our employees, customers and contractors.

The Group Executive and Board are committed to delivering tangible improvements in health and safety culture, performance and practice. A report of Group health and safety is provided to the Group Executive each month, and the Audit Committee and Board conduct regular reviews of incidents, trends and overall performance. The result is a clear focus on health and safety throughout the Group, providing a firm base from which to achieve our targets over the coming years.

## Governance of Corporate Responsibility

The Group sets annual objectives and targets for the areas covered in the report above. These are considered and reviewed by the *Board and progress is monitored throughout* the year by the Group Executive and Executive teams in each Division. A Group Corporate Responsibility Committee is responsible for ensuring day-to-day actions and sharing of best practice. Health & Safety performance is reviewed regularly by the Board throughout the year.

## Approval

This Strategic Report has been approved by the Board and signed on its behalf by:

**Dennis Millard**
Chairman
15 October 2014

**Community**
Our businesses play an important role in their communities. We believe that giving something back is important and our staff take great pride in the contributions they make beyond the workplace.

The Group co-ordinates a year-round community programme which includes volunteering opportunities and fundraising events. We encourage staff to take an active role and celebrate successes both large and small. Our volunteering policy enables staff to take time to support good causes that are important to them. In total, our staff have raised over £80,000 for good causes throughout the year.

The Group's businesses have a particular interest in supporting literacy skills. Since 2013 we have been working with the Bath Rugby Foundation, supporting a bespoke literacy programme in primary schools. The programme, known as Stickability, combines classroom teaching with sport based activities to encourage involvement and engagement among the pupils. The programme has been a tremendous success and the Group has committed to a further two years' partnership, extending the reach of the initiative to many more schools.

Given the wide reach of the Group and our policy of supporting initiatives that are close to our individual businesses, we partner with many other charities. This year we have sponsored initiatives with and raised funds for, amongst many others, the National Literacy Trust, Newstraid, Wiltshire Air Ambulance, Cancer Research UK, Whizz-Kidz, DASH and East Anglian Air Ambulance.

**Our markets**
Working with industry partners is an important element of our approach to corporate responsibility. Each division contributes to its respective industry bodies, playing an active role in environment, workplace and marketplace initiatives. This ensures we maximise the impact of our work and in many cases opens up new opportunities for improved practice.

Given the unique structure of the newspaper and magazine industry, our News & Media division has particular responsibility to ensure the wide dissemination of newspapers and magazines to communities across its exclusive distribution territories. We have clear policies to ensure all communities are served including those in remote rural areas. We support the industry's retail charter which provides clear guarantees of service and a process for restitution in the event of failure by parts of the supply chain.

# Committed to raising standards

The newspaper and magazine distribution markets are unique in their combination of scale, complexity and time sensitivity. Every day Smiths News performs a 'nightly miracle' reaching thousands of retailers on time and without a hitch. But occasionally things can go wrong and we recognise that can have an impact on our retail customers.

The Press Distribution Charter is a guarantee of good service. It encompasses a set of voluntary standards, developed by the industry and adopted in full by Connect News & Media.

The charter sets out the standards retailers can expect from publishers and wholesalers. It helps them find solutions if things go wrong, and we aim to resolve the vast majority of concerns quickly and informally. For more serious issues the Charter has a complaints process and an independent review panel. Any complaints we receive are carefully reviewed and we work hard to amicably resolve all reasonable concerns.

Adopting the Charter is part of our commitment to continually improving service and partnership across our supply chains.

# Committed to acting responsibly

**The Group is committed to finding further sustainable reductions in its environmental footprint.**

**We believe that giving something back is important and our staff take great pride in the contributions they make beyond the workplace.**

The Group is committed to responsible practice, taking an active approach to monitoring and improving our impact on the environment, our markets, our workplaces and wider communities. We share best practice across our businesses and work with industry partners to ensure actions take into consideration the needs and opportunities in our wider Group.

**Environment**
We continue to make good progress in reducing our environmental impact.

In August 2014 the Group was recertified by the Carbon Trust, recording an absolute reduction of 13.4% in carbon emissions over the compliance period. This positive performance was a result of a wide ranging programme to control and monitor fuel and utilities, continual re-evaluation of our operational practices, improved recycling and the introduction of further energy saving measures, such as LED lighting.

The Group is committed to finding further sustainable reductions in its environmental footprint. Over the coming year we plan to extend our reporting dashboards to drive improvements and increase awareness of the importance of energy reduction. The programme of installing LED lighting will be extended and we will commission a series of energy audits to identify further opportunities for long-term improvement.

**Carbon emissions data**

| Fuel Type/Scope | 1 March 2013–28 February 2014 $tCO_2e$ |
|---|---|
| Scope 1 | 5,046 |
| Scope 2 | 6,372 |
| Scope 3 | 13,702 |
| **Total** | **25,120** |

**Notes:**
The data collected for this report is in respect of the year 1 March 2013–28 February 2014, being the period that the Company reports under for the Carbon Trust Standard certification. The single year of data reported this year will provide a consistent baseline and the Group proposes to use these results as its benchmark to compare environmental performance in future years.

Using an operational control approach, the Group has assessed its boundaries to identify activities and facilities for which it has responsibility for the greenhouse gas (GHG) emissions from Scope 1 and 2. The Group has also decided to voluntarily report on selected Scope 3 emissions, namely, our subcontracted mileage (where possible to obtain) and employee business travel.

The Group considers it to be impractical to collate data from global operations (a number of satellite locations overseas). These are 'de minimis' emissions in relation to the Group's overall carbon footprint.

Total greenhouse gas emissions were calculated following ISO-14064-1:2006 standards and using DEFRA 2014 and 2012 emissions factors.

Scope 1 (gas and fuel) emissions relate primarily to the consumption of gas to heat the Groups' distribution locations and the fuel consumed by our company cars and commercial vehicle fleet. Scope 2 emissions consist of the electricity used in our offices and depots.

| Financial measure | FY2014 result and narrative | Further reference | Guidance FY2015 |
|---|---|---|---|
| Shares | – As at 31 August 2014 the weighted average basic number of shares issued was 186.3m (FY2013: 182.2m).<br>– As at 31 August 2014 the fully diluted number of shares was 192.6m (FY2013: 193.9m).<br>– Fully diluted shares include 4.8m for employee incentive schemes (FY2013: 7.2m) and 1.5m shares (FY2013: 4.5m) being the weighted impact of future share schemes and shares allotted in relating to The Consortium deferred consideration. | Note 10, page 83. | The Group expects to issue approximately 2m shares pa to meet future employee incentive scheme requirements. |
| Acquisitions | – During the year, the Group made no new significant acquisitions. | Note 12, page 85.<br>Note 13, page 85. | Bank facilities and covenants provide sufficient financial headroom for the Group to support growth through further acquisitions financed by debt, with further capacity available through the raising of equity if efficient to do so. |
| Critical Accounting Policies | – The directors believe that the accounting policies below represent those which require the greatest exercise of judgment. The directors have used their best judgment in determining the estimates and assumptions used in these areas but a different set of judgments could result in material changes to our reported results.<br>– Retirement benefit obligations.<br>– Impairment of goodwill.<br>– Revenue recognition.<br>– Valuation of acquired intangibles<br>– Onerous property contracts.<br>– Taxation judgments. | Note 1, page 69. | |
| Going Concern | – The Group meets its day-to-day working capital requirements through its bank facilities of up to £200m. The Groups forecasts, taking into account the Board's future expectations of the Group's performance, indicate that there is substantial headroom within these bank facilities and the Group will continue to operate well within the covenants attaching to those facilities.<br>– Despite the uncertain economic environment, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus the Group continues to adopt the going concern basis in preparing its consolidated financial statements. | Note 20, page 88. | |

# Financial review continued

| Financial measure | FY2014 result and narrative | Further reference | Guidance FY2015 |
|---|---|---|---|
| Covenants | – The Group remains comfortably within each of its banking covenants.<br>– Net debt/adjusted EBITDA was 1.4x (FY2013: 1.5x) versus a covenant limit of 2.75x.<br>– Interest charge cover was 11.8x (FY2013: 13.9x) versus a covenant minimum of 3.0x.<br>– Fixed charge cover was 4.7x (FY2013: 5.3x) versus a covenant minimum of 2.0x.<br>– Guarantors cover exceeded 80% annual consolidated turnover, gross assets and pre-tax profits. | | The Group expects to remain comfortably within covenant limits with net debt/EBITDA continuing to decrease before any new acquisitions as a result of decreased debt. |
| Bank Facilities | – The Group had £200m of committed bank and Treasury facilities in place as at 31 August 2014 (FY2013: £177m).<br>– The Group completed a refinancing in January 2014 securing facilities of £200m through to November 2018. The facility comprises a term loan of £50m with limited repayment over the term period and a revolving credit facility of £150m.<br>– Interest rate hedges, used to manage exposure to interest rate fluctuations, covered 100% of the Group's core borrowings as at 31 August 2014. | Note 20, page 88. | The Group expects to continue to have headroom within these facilities in line with those seen in FY2014. |
| Pensions | – The Group operates three defined benefit schemes, closed to new entrants and future accrual.<br>– The Smiths News section of the WH Smith pension trust has assets of £507.3m and an actuarial deficit of £23.0m as at June 2013 (March 2009: £50.0m) with a deficit repair agreed at £4.1m p.a. until March 2019 (March 2009 £5.8m p.a. for ten years). As at 31 August 2014 the IAS19 surplus of £75.7m (FY2013: £53.2m) was not recognised in the accounts as the amount available on a reduction of future contributions is £nil.<br>– The Group recognises the present value of the agreed schedule of future contributions as a pension liability of £17.3m on the balance sheet (FY2013 restated £20.3m).<br>– The Consortium defined benefit schemes have combined assets of £15.3m and a combined actuarial deficit of £1.4m as at December 2010. As at 31 August 2014 the IAS19 deficit was £3.7m.<br>– The total cash contribution of defined benefit schemes and expenses in the cash flow statement for FY2014 was £4.6m (FY2013: £6.5m) the reduction being as a result of the reduced deficit repair in the Smiths News section. | Note 6, page 79. | The Group expects cash contributions for FY2015 to be at a similar level to FY2014. |
| Balance Sheet | – As at 31 August 2014 total equity deficit was £42.1m, (FY2013: £56.9m).<br>– As at 31 August 2014 distributable reserves were £55.3m (FY2013: £73.0m).<br>– There have been no material events after the balance sheet date. | Group balance sheet, page 66.<br>Company balance sheet, page 101. | The Group expects to continue to generate profits and retained earnings further reducing the equity deficit position in FY2015. |

| Financial measure | FY2014 result and narrative | Further reference | Guidance FY2015 |
|---|---|---|---|
| Underlying Results | – Underlying operating profit of £55.5m was down 1.6% (FY2013: £56.4m) with profit growth in News & Media and Education & Care being offset by a disappointing year in the Books division.<br>– Underlying profit before tax of £50.0m is up 0.2% (FY2013: £49.9m).<br>– Basic underlying earnings per share of 21.7p is up 2.8% (FY2013: 21.1p).<br>– Fully diluted underlying earnings per share of 21.0p is up 6.1% (FY2013: 19.8p) as a result of releases in prior year tax credits. | Note 2, page 75<br>Note 10, page 83. | The Group has started FY2015 trading in line with current forecasts and provides updates to the markets throughout the year. |
| Finance Cost | – Net underlying finance costs were £5.5m (FY2013: £6.5m). Net bank interest and related charges were £5.9m (FY2013: £6.8m) as a result of lower average borrowings throughout the year. In addition, finance costs include the favourable impact of fair value movements in interest rate hedges of £0.4m (FY2013: £0.3m). | Note 7, page 82. | The Group continues to have most of its debt protected by interest rate hedges, finance costs in FY2015 are expected to remain at a similar level to FY2014. |
| Non-Recurring and Other Items | – Non-recurring and other items totalled £6.9m (FY2013: £11.0m) before tax and £5.9m after tax (FY2013: £9.7m).<br>– Network reorganisation costs £3.0m (FY2013: £3.3m), acquisition and disposal costs £0.9m (FY2013: £3.7m), amortisation and impairment of acquired intangibles £3.5m (FY2013: £2.8m) offsetting other credits of £0.5m. | Note 4, page 77. | The Group expects to incur network reorganisation costs in FY2015 at a similar level to FY2014. |
| Statutory Results | – Statutory profit before tax of £43.1m is up 10.8% (FY2013: £38.9m).<br>– Basic earnings per share of 18.6p is up 18.5% (FY2013: 15.7p).<br>– Fully diluted earnings per share of 18.0p is up 21.6% (FY2013: 14.8p). | Note 2, page 75.<br>Note 10, page 83. | The Group expects statutory results performance to follow underlying results performance. |
| Taxation | – The underlying tax charge was £9.3m (FY2013: £11.5m), the effective underlying tax rate was 18.7% (FY2013: 23.0%) as a result of lower UK statutory tax rate and tax provision releases.<br>– The statutory tax charge was £8.3m (FY2013: £10.2m), the effective statutory tax rate was 19.4% (FY2013: 26.2%) with a tax credit on non-recurring and other items of £1.0m in FY2014 compared to a credit of £1.3m in FY2013. | Note 8, page 82. | The Group expects its future tax charges to be broadly in line with standard UK corporation tax rates. |
| Dividend per share | – The interim dividend per share of 3.1p up 3.3% (FY2013: 3.0p) was paid on 11 July 2014.<br>– The proposed final dividend of 6.6p up 4.8% (FY2013: 6.3p) will be payable to shareholders on the register at 9 January 2015 on 6 February 2015.<br>– The total proposed dividend for FY2014 of 9.7p is up 4.3% (FY2013: 9.3p). | Note 9, page 83. | The Group has a progressive dividend policy, expecting to grow future dividends as the Group achieves future profit growth. |
| Cash and debt | – The Group continues to deliver strong free cash flows delivering £37.2m (FY2013: £32.6m), up 14.1%. This included a working capital inflow of £1.2m (FY2013: outflow of £5.0m), capital expenditure £10.3m (FY2013: £7.9m), net interest paid £6.1m (FY2013: £4.2m), taxation £9.8m (FY2013: £10.5m), pension funding £4.6m (FY2013: £6.5m) and other cash inflows of £3.3m (FY2013: £2.7m).<br>– As at 31 August 2014 net debt was £93.0m (FY2013: £98.5m). Net debt is a combination of £113.4m of gross debt and £20.4m of cash held in local entities held to finance local operations.<br>– The Group borrowings are cyclical during the financial year resulting in average borrowings £8m higher than the closing position and maximum borrowings of £42m above the closing position. This resulted in an average headroom of £102m throughout the year. | Note 27, page 94.<br>Group cash flow statement, page 68. | The Group expects to continue delivering strong free cash flows for FY2015.<br><br>The Group expects to continue to pay down borrowings from net cash by approximately £5m in FY2015, before any new acquisitions. |

# Strong financial performance

The Group has delivered a strong performance from two of its three divisions representing 90% of our profit. We have maintained good shareholder returns through growth in earnings and dividend.

**Nick Gresham**
**Chief Financial Officer**

Connect Group PLC

Underlying PBT
£50.0m
+0.2%

Underlying EPS
21.7p
+2.8%

Underlying DPS
9.7p
+4.3%

Free cash flow
£37.2m
+14.1%

### Overview

The Education & Care division has returned a solid performance in the face of increasing competition in the marketplace and underlying operating profit of £7.8m is up 5.0% on the previous year (2013: £7.4m). The division's financial results were impacted by some non-core sales losses, which though anticipated, mask a stronger performance in core education. Overall, the division's strategy is on track.

### Markets

The long-term prospects for the education consumables market remain positive despite the short-term tightening of public spending. Demographic trends are driving an increase in the number of children in education and Government policy changes are increasing the flexibility of schools to control their budgets. Similar characteristics apply to the Care sector, albeit this is a small part of the division's revenue.

This year we have witnessed increased activity from competitors, including the larger Public Sector Buying Organisations (PSBO) which are expanding their ambitions beyond their traditional territories. Despite these challenges, the division has grown sales in primary and secondary education by 4.8% and Early Years by 13.8%, in part helped by our own expansion into new territories.

There are no independent measures available for UK sales of consumable products to the Care market. However, it is clear that overall demand will grow in line with an ageing population. A significant trend is the growth of Care companies operating multiple facilities and with the buying power to negotiate exclusive contracts. This presents an opportunity but we are conscious of the need to drive profitable sales.

### Operational progress

A passion for customer service is at the heart of our Education & Care division. Under the leadership of a new management team, we have completed a comprehensive review of the customer experience: from websites to physical deliveries, as well as to administration and account management. The outcome is a clear plan that will ensure we offer a market leading customer-centric proposition in the marketplace. Over time, this will mean better and more bespoke targeting of the core ranges and seasonal promotions, further supported by continued investment in customer service systems and operational technology.

Good progress has been made in integrating the ranges and administration processes of our two main businesses: The Consortium and West Mercia Supplies (WMS). This has been a major project which, given the industry's reliance on catalogues, required much planning and co-ordination as well as a careful assessment of customer needs. The result is an expanded and better targeted range, with less overlap between the companies and fewer overall product lines to service.

Our new catalogues have been well received. For WMS, in particular, they create a step change in the customer offer which has helped to drive sales. In addition to the core catalogues we have invested in more targeted offerings for Early Years, Sports Equipment and Care. Looking ahead, we plan on developing partnerships with key suppliers that will provide us with exclusive products and promotions, helping to build our 'classroom authority' and provide a greater range of bespoke offers for customers.

Continued investments in our warehouse and demand planning systems have improved efficiency of the logistics operation. In June we opened a new warehouse near our main facility in Trowbridge replacing two off site locations that will help to reduce costs and improve processing. We continue to review ways to increase operational efficiencies between our two main sites in Trowbridge and Shrewsbury.

A strategic goal for the division has been the expansion into new areas beyond our 'heartlands' of the South West and West Midlands. Contract wins in Scotland and Northern Ireland have provided this foothold and we are pleased with the early progress in these new territories.

Sales through our West Mercia Supplies business have been impacted by the loss of regular orders of stationery supplies to West Midlands local authorities. This was a legacy of WMS's previous ownership and we had anticipated the loss. Nonetheless, it has impacted sales this year and masked a stronger underlying performance. We will continue to see a further reduction in sales as the contracts come to an end.

The growth of academy status schools is a positive trend for the division. The status gives schools more control of their budgets and greater choice of suppliers. Our sales through academy groups have been strong and we are forecasting further growth as more schools choose to go down this route.

The Early Years sector, which supplies pre-school nurseries, had an exceptionally strong year with sales up 13.8%. The sector is especially well suited to our 'one stop' and customer focused offer. We have made contract gains with a number of large customers – a positive development as this sector consolidates, with a greater mix of 'group nurseries' compared to the smaller independent providers.

The division's Care sector, though a relatively small operation, has performed less strongly. We are reassessing our offer for this market to ensure a more competitive proposition, with particular attention to the service required by Care providers.

Other challenges for the division this year included the decline in international sales through MOD schools, which in many cases have been identified for closure. The market has also become more competitive with keen pricing from suppliers seeking to increase market share. These developments will be considered and addressed in our forward planning and through an ongoing review of key line pricing and loyalty promotions.

### Future priorities

The future for the division is positive. Our core markets are in growth and we have a leading customer proposition. We will continue to invest in the customer experience, improving our websites and Customer Relationship Management systems. Our plans include more targeted offers for specific customer groups and we are prepared to invest to grow our customer footprint with contracts in new regions. We remain alert to opportunities for further acquisitions that would complement the division's existing businesses.

# Operating review continued

**With a nationwide distribution network and a comprehensive product range, we are trusted by customers of every size to supply them with the equipment they need. And with a burgeoning online presence and dedicated sales team, we plan to go on expanding in the future.**

**Glenn Leech**
**Managing Director**

## Education & Care Highlights

- Good sales performance in core categories +4.7%
- Strong core peak trading +5.7%
- 22% total profit growth since acquisition
- Range integration driving improved sales and gross margin
- Gains in Scotland and Northern Ireland
- Competitive environment, but market fundamentals and demographics remain strong
- Further investment to enhance our customer proposition

**Education & Care**

| | |
|---|---|
| LFL Revenue: 3.1% | % of Group operating profit: 14% |
| Total Revenue: £64.9m +1.7% | Underlying Operating Profit: £7.8m +5.0% |

- 30,000 customers throughout the UK
- 30,000 catalogues produced annually
- 40,000 products available to customers

**Overview**
Connect Books had a challenging and volatile year and underlying operating profit of £2.5m was down 65.7% on the previous year (2013: £7.2m). A combination of difficult trading, the impact of mix changes and increased operational costs has stalled the significant progress we had made in recent years. We have taken action to address those areas in our control. These actions have stabilised the business and we have established a new team with a plan for sustainable improvement.

**Markets**
The books market as a whole is in a period of flux and transition. The growth of eBooks and internet retailing are well publicised trends. These affect the operating model of publishers as well as traditional retailers. The academic and public library sectors have also been affected by changes to funding, further increasing the pressure on sales and margin.

The total consumer market for books in the UK fell by 2.8%. Connect Books performed broadly in line, with LFL sales decreasing by 2.5%, although our total sales increased by 3.0%. Sales were boosted by the strong growth of Wordery, which has exceeded expectations with sales of £24.7m, up 50.9% on last year, on a like for like basis.

This top line performance, however, masks a higher than anticipated shift from high street sales to lower margin internet fulfilment. While Connect Books has benefited from sales growth of online channels, the scale of the shift and the impact on independent booksellers has negatively impacted unit costs and margin mix.

As mentioned above, independent booksellers are struggling in the face of increased competition. Closures this year mean there are now in the region of only 1,000 established independent book retailers across the UK. Conversely, our sales to supermarkets and high street chain retailers have had a relatively strong year.

There are no independently published measures for sales through academic and public libraries but it is clear that demand has been weakening. This reflects the continued squeeze on public spending and concerns over student admissions and funding in the academic sector. UK public library sales were down by 14.2%, and we expect this market to remain challenging. The growth in demand for digital services to academic markets, which has been a feature of recent years, has slowed as universities reassess their total budgets. Digital sales of £8.4m were marginally down 0.8% on last year.

International sales have been mixed with strong competition in European markets. Our operations based in Netherlands, France and Spain have won and retained contracts, and our academic digital offer has been upgraded with bespoke interfaces for the larger European markets.

**Operational progress**
Our priority has been to embed a sustainable improvement plan which responds directly to the immediate challenges but does not put at risk our long-term progress. An operational process review has looked closely at the warehouse in Norwich and its most appropriate configuration for the future. This identified a number of opportunities, and highlighted that the pack-line technology we introduced in 2013, to manage an anticipated increase in internet fulfilment, was not operating as effectively as expected. We have subsequently addressed these issues, by reducing headcount by 15% and introducing more flexible hours. The new technology is now stable and starting to make an improvement to productivity.

In contrast to the operational difficulties, the success of Wordery, our business supplying books to consumers through online channels, has been a highlight of the year, with sales up by over 50%. Our online marketplace offer continues to grow, and the launch of a bespoke website has created a platform for direct sales at better margins than those through 'market place' channels. The growth of our website sales has been slower than initially forecast, but this is more than offset by marketplace channels and international sales growth.

Following further review of the division we have structured the management teams into four customer focused channels: Bertrams (UK wholesale), Dawson Books (UK academic and public libraries), Wordery (marketplace and Wordery.com) and International (combining Erasmus, Houtschild, Dawson France and Dawson Spain). This means each channel has a dedicated commercial team, able to shape and market its offer to the needs of its sector, with responsibility for associated costs and profitability.

Our investment in digital services for universities continues. We have upgraded the capabilities of Dawsonera, our digital portal, increasing the number of titles for users and improving the customer experience with a more flexible and personalised interface. Versions have been launched for Spain, Germany, France and Netherlands.

International sales have been mixed. Our Netherlands based businesses (Erasmus and Houtschild) have performed to plan, winning new contracts and continuing to see solid demand from existing customers. Dawson France and Spain have had weaker sales, reflecting the tighter conditions in those markets. More positively we have recently won small contracts in Colombia, Brazil and Mexico, and are pursuing other opportunities in South America.

**People**
Despite the difficult trading, the volume of physical book processing has been higher than ever and we recognise the outstanding efforts of our staff throughout the year. The reductions in headcount at our Norwich distribution centre were taken only after careful review. A voluntary scheme helped to reduce the number of compulsory leavers, but some were inevitably required, given the reduced profitability of the business.

The wider Group has provided additional support to Connect Books, with leadership inputs in IT, Finance, Operations and Strategy. Working together we have supported the management teams during a difficult period and been able to provide expertise that would not otherwise have been available.

In May 2014, our Managing Director, Graeme Underhill, announced his decision to retire after nearly 40 years of service. Graeme's successor will be Justin Adams who will join the business in early November 2014. The senior management team at Connect Books has also seen significant change; we have appointed new IT, Finance and Supply Chain directors and are recruiting for a small number of roles that will bring fresh thinking and appropriate new skills to the leadership team.

**Future priorities**
After a year in which many challenges came at once, we believe the division has stabilised. Our business plan will continue to drive for share and revenues in growing sectors of the total books market, but with greater attention to making the appropriate return from each opportunity.

Looking ahead there are three key growth opportunities: building Wordery and migrating customers from marketplace channels to the bespoke website; improving our digital offer to win further market share; and international expansion of our academic service. These opportunities will be based on a foundation of an efficient and compelling core business and increasingly efficient central warehouse in Norwich.

# Operating review continued

**The world of bookselling is changing, and our Books division is responding to the transformation. We are a multi-channel business, operating in a range of sectors to deliver books and eBooks to retailers, consumers and libraries throughout the world.**

**Graeme Underhill**
**Managing Director**

## Books Highlights

- Total revenue growth +3.0%
- Sales mix, margin dilution and challenging Academic and UK Libraries markets
- Investment returns & cost challenges impacting profitability
- Wordery delivering 50% growth
- Performance stabilised in recent months
- Further recovery actions being implemented
- Strengthened management team

**Books**

| | |
|---|---|
| LFL Revenue: -2.5% | % of Group operating profit: 5% |
| Total Revenue: £193.7m +3.0% | Underlying Operating Profit: £2.5m -65.7% |

- 80,000 customers in 96 countries throughout the world
- 20m books dispatched annually
- 185,000 sq ft UK-based warehouse

**Overview**
The News & Media division has performed strongly and underlying operating profit of £45.2m is up 8.1% on the previous year (2013: £41.8m). A combination of a more resilient market and continued cost efficiencies has grown profit above expectations. The division has also won substantial new business, targeted investments that will help to sustain performance, and made clear progress in the development of complementary profit streams.

**Markets**
The newspaper market has shown pleasing resilience, helped by new retailer promotions and strong price increases on Daily and Sunday titles. Newspaper sales of £950m were up 0.9% and down 0.7% on a LFL basis. Magazine sales were weaker, albeit the rate of decline improved against recent years. This market remains challenged by the growth of online media and a number of titles ceased publication in the year. More positively we have seen some increases in price on key 'celebrity' titles that have helped to improve revenues from this important sector. Combined sales of weeklies and monthlies were £439m, down 6.4% on last year.

Both the newspaper and magazine markets benefited from the World Cup and associated special editions and collectables. The cyclical nature of these gains is now well established and while these will not be repeated in the coming year, we anticipate the opportunity for uplift associated with the European Football Championships in 2016. In September 2013 we acquired Martin Lavell, a specialist in corporate newspaper and magazine delivery, serving large companies in London.

The combined performance of newspapers and magazines remains comfortably within our medium-term strategic forecast, which anticipates a decline in turnover of between 3% and 5% per year.

For DMD, our specialist international media distributor, the market for in-flight print media has remained broadly stable. Over 50% of customers are served by long-term contracts and the sector as a whole shows less volatility to unit price and promotions. In-flight digital media is still a fast changing market but we have seen increased interest and demand for new solutions with DMD making further progress in winning customers. Underlying revenue for DMD was £25.1m, down 3.3% on last year.

**Operational progress**
**Smiths News** continues to deliver the efficiency targets that are central to maintaining profitability in its mature markets. Efficiencies of £6m were achieved in the year, and the business has now delivered £15m of the £20m, three-year target of annual savings we set in 2012.

Contract renewals mean that contracts with publishers representing 84% of our current newspaper and magazine revenues are now secured through to at least 2019. A number of new regional contracts were also won including significant wins with Trinity Mirror, and Newsquest. These contracts facilitate our network strategy and this year we have consolidated operations across a number of distribution centres, including the closure of the Wimbledon and Salisbury depots.

In February we commenced distribution of the Metro newspaper across London. This is a major operation with deliveries to over 1,600 drop points five days a week, and is scheduled separately from the core retailer deliveries. The process was not without significant challenge and we have worked closely with Metro to meet the exacting service requirements associated with this dedicated service. The initiative is a good example of how our skills can be adapted to complementary distribution opportunities.

Innovative technology has long been central to our lean business model and leading customer service. This year we have trialled new picking systems, using hand-held scanners that will improve accuracy and reduce cost. In August 2014 we launched SNapp, a mobile application that gives retailers direct access to their account, enabling them to amend standing orders, complete various administrative tasks and make enquiries online.

We believe SNapp will improve service to our retail customers through speedier two-way communication – it is indicative of the continued innovation and value that Smiths News continues to bring to its markets.

In June and July the business suffered from a number of system outages, caused by failures in services supplied by technology partners to our data centre. Our recovery plans ensured the impact on service was minimised, and we have implemented a series of measures to ensure more robust monitoring of our technology platforms and partnerships. The systems are now stable but we will remain vigilant in our assessment and monitoring of risks.

**DMD** renewed its contract with British Airways, extending the agreement through to 2019. This is DMD's largest customer and anchors the central operation based at our London Travel Distribution Centre at Heathrow. Other significant contracts include new agreements with Eurostar, Delta Airlines and Cathay Pacific, and a contract with Trinity Mirror to distribute to regional airports across the UK. The outsourcing of DMD's UK operations to Smiths News has delivered efficiencies and improved service, and our security accreditation by the Department for Transport provides a strong underpinning to the quality of our airside service and competitive advantage.

The in-flight digital opportunity continues to grow but remains small in comparison to printed media. DMD is now supplying over 14,000 iPads to airlines, supplementing these with media content. In 2013 we launched 'Digireedoo', a media portal for travelling customers – trials have been extended to Manchester, Paris and Frankfurt airports.

**New revenue development**
Our strategy for the News & Media division recognises the potential opportunity to use our network for other products and services. We have set out to explore these as a means to complement the revenues of newspapers and magazines, but without impacting our core operations. This year we have made good progress.

In February Smiths News launched Jack's Beans, a premium vended coffee offer for retailers which can be serviced through our existing network. The business model requires careful targeting of the retail sites, as performance can vary widely depending on the type of customer traffic. After early trials we are now clear on our target customers and have 120 machines in operation – we plan to increase this, potentially to 500 machines in the next phase.

In October 2014 we launched Pass My Parcel with Amazon, a time-sensitive 'click and collect' service, delivering parcels to nominated retailer 'drop points'. In the launch phase we will establish a network of 550 drop points within our daily distribution footprint. The growth in internet retailing has created a space for alternative and more efficient delivery solutions than the traditional 'direct to home' offer. It is early days, but we believe this is an exciting development and we are liaising closely with Amazon as we expand and develop the service. It is also an excellent example of how our network can be used to serve other suppliers.

**Future priorities**
The strategy for the division is on track. Having secured contracts for the vast majority of our revenues until at least 2019, we can continue with our efficiency targets and work with industry partners to ensure a lean and sustainable supply chain. We will maintain our investments in technology and continue to develop and support our people to ensure we maintain our outstanding service and industry leadership. The development of new revenues remains a priority and will continue in tandem with the ongoing strength of our core business. To support this vision we will invest in customer services and pay particular attention to the bespoke needs of new customer groups, adapting and strengthening our existing skills.

# Operating review

**At the heart of Connect Group's News & Media division is Smiths News, recognised as the best news wholesaler in the business. We're proud of this legacy, and are working hard to safeguard it for the future.**

**Jonathan Bunting**
**Managing Director**

## News Highlights

- Strong profit increase +7.3%, supported by World Cup sales
- Newspaper sales and promotions driving revenue performance
- Sales run rates ahead of medium-term forecasts
- 84% of total revenues contracted until 2019
- £6m cost savings in FY2013/14, £15m of £20m target achieved to date
- SNapp launched August 2014
- Launch of innovative new organic revenue streams

## Media Highlights

- Strong profit growth in FY2013/14
- 50% of revenues secured on long-term contracts
- New distribution operation opened in Thailand
- Operational integration driving efficiency
- Continued growth of digital content services
- 14,000 tablets deployed across 20 airlines

| News | Media |
|---|---|
| LFL Revenue: -2.1% | LFL Revenue: -0.6% |
| Total Revenue: £1,525m -0.3% | Total Revenue: £25.1m -3.3% |
| Underlying Operating Profit: £42.9m +7.3% | Underlying Operating Profit: £2.3m +22.8% |
| % of Group Operating profit: 77% | % of Group Operating profit: 4% |

| Performance indicators | 2013/14 | 2012/13 |
|---|---|---|
| On Time Delivery | 96.7% | 97.2% |
| Newspaper Pick Accuracy | 99.8% | 99.8% |
| Newspaper Returns Accuracy | 98.5% | 99.0% |
| Magazine Pick Accuracy | 99.6% | 99.7% |
| Magazine Returns Accuracy | 100.0% | 100.0% |

# Our values

### A Better Way

Determined to get better at what we do and how we do it.

### Fresh Thinking

Having the courage to embrace change and try new things.

### Mutual Respect

Acting with integrity and showing respect for others.

### Partnership

In it together – building stronger working relationships for shared success.

### Trusted Service

Winning trust by giving outstanding service.

Communicating our Values.

The traditional books market is in a state of transition with the rapid evolution of internet retailing, the digitisation of content, and pressure on public and academic library funding. Forecasting in this environment is fraught with uncertainties, but we believe opportunities remain and that our long-term strategy is the most appropriate. We will continue to direct and make investments that strengthen our competitive position in the growing sectors of the market.

**Connect Education & Care**
Connect Education & Care continues to perform well, showing growth in its core education sector categories. Profit and sales were impacted by the loss of some supplementary sales to local authorities which, though anticipated, dampened overall performance. Good progress was made in expanding into new regions and the division had strong peak sales (up +5.7%) which reflected the improved range and customer promotions. Underlying operating profit of £7.8m was up 5.0%.

The education sector remains an attractive market for specialist distributors with demographic trends indicating further growth potential. We can expect competition to intensify but the division is well placed for continued growth. Looking ahead, we will invest in our supply chain and information systems, and build closer relationships with selected suppliers that will provide us with exclusive content and promotions to build our classroom authority. Our plan is to source and promote the most customer focused range, backed by outstanding customer service and leading technology to give us an edge in customer relationships and new business targeting.

**Strategic direction**
We believe that Connect Group has a clear and achievable strategy.

Our skills are best suited to large and complex supply chains, in which the expertise of a specialist intermediary is critical to an efficient marketplace. Since 2006 we have expanded our core businesses and diversified into carefully chosen sectors that complement and leverage our skills and assets. Our medium-term target is to achieve 50% of underlying profits from activities outside of newspaper and magazine wholesaling.

The Group's structure means we operate in a range of markets that at any one time may differ in terms of their opportunity, evolution and business cycle. Our chosen markets reflect our underlying goal of achieving a more balanced portfolio of interests, which will facilitate the sharing of skills and resources across the Group, strengthen our individual businesses, and create a platform for further growth.

To realise this strategy will take time and some flexibility to be able to respond to opportunities and challenges. Importantly, the strength of our current businesses means we do not have to be rushed in our choice of new markets, nor overreact if there are short-term fluctuations in market conditions. Our vision for the future of the Group includes a combination of further acquisitions, including the potential to expand into new but complementary sectors, the expansion of our divisions with 'bolt-on' opportunities, and investment in new products and services which utilise our existing supply chains and customer relationships.

**People and values**
The Group's performance and culture is underpinned by outstanding people.

Our operations are unremitting and every day of the year our managers and staff display a combination of determination and expertise that is required to meet customer needs. I would like to pay tribute to their efforts, acknowledging that without their skill and dedication the Group could not achieve its goals.

This year we spent considerable time listening to our staff and capturing the underlying values of the Group. It did not surprise me that there was a strong correlation of views across all our businesses, nor that the values expressed are grounded in practical virtues as well as aspiring for a continual improvement. These qualities will become the foundation of the Group's culture; they come 'ground up' but they apply to all levels of the Company – they are values we are proud to own and work by.

Throughout the year, my colleagues on the Group Executive have provided invaluable insight as well as excellent leadership of their divisions and functions. I am indebted to them for their support.

**Mark Cashmore**
Group Chief Executive

# Group Chief Executive's review

# Another year of progress

**Our new name describes perfectly what we do best: connecting suppliers to customers in ways that make us an essential link in their supply chains.**

**Group Overview**

The Group has delivered a solid performance, responding to conditions in some of our markets that were more challenging than in recent years. Underlying profit before tax is £50.0m (2013: £49.9m) and statutory profit before tax is £43.1m (2013: £38.9m) reflecting growth in the News & Media and Education & Care divisions offset by a weak performance in our Books division. Underlying EPS is up by 2.8% and Free Cash Flow of £37.2m, is up 14.1% supporting a dividend of 9.7p up 4.3%.

Over the last five years the Group's strategy to diversify into new specialist distribution sectors has helped to increase underlying profit before tax by £15m, equating to 42.9% growth over the period. This year's results demonstrate our increased resilience to the fluctuations in markets that will occur from time to time as we diversify into more sectors. Looking ahead, we plan to further widen the scope of the Group. We are committed to a medium-term target of achieving 50% of underlying profits from activities outside of newspaper and magazine wholesaling.

**Rebranding**

In April 2014 we renamed and rebranded the Group. In 2006, when we commenced life as an independent PLC, we only operated in the newspaper and magazine market. Our name of Smiths News PLC was appropriate at that time, helping to maintain our heritage during a period of transition. The change to Connect Group PLC reflects our progress since then, and our aspirations for the future. The Group is now a broad based specialist distributor and the name describes perfectly what we do best: connecting suppliers to customers in ways that make us an essential link in their supply chains.

At the time of the rebranding we took the opportunity to simplify our reporting structure. Each of the Connect Group divisions has a clear sector focus, with operating companies that are recognised leaders in their chosen markets. The new structure is flexible and can accommodate further expansion as the Group continues to grow its existing businesses and diversify into new specialist distribution markets.

**Connect News & Media**

The News & Media division delivered another outstanding performance, benefiting from excellent operational and cost control and the continuation of a long-term strategy based on investing to deliver efficiencies and service leadership. Underlying operating profit was up by 8.1% to £45.2m.

During the year Smiths News further strengthened its contractual position such that publishers representing 84% of our current newspaper and magazine revenues are now secured through to at least 2019. This enables us to plan and support the further evolution of our network and processes, allowing us to sustain profitability in what are very mature markets.

Looking ahead, business will be further supported by investment in carefully researched opportunities to grow complementary revenues. In October 2014 we announced the launch of Pass My Parcel, an innovative 'click and collect' service which leverages our infrastructure and meets a clear market need. We are pleased with the early progress and are working to expand the service, liaising closely with Amazon. Earlier in the year we launched Jack's Beans, a premium vended coffee offer, primarily delivered through our independent retail customer base and served by our existing network.

DMD, our specialist media supply business won new print contracts and continues to develop its digital and in-flight entertainment offers. This year we opened a new facility in Bangkok airport, one of the world's fastest growing airports. The business also benefits from the operational synergies and commercial expertise within the News & Media division.

**Connect Books**

Connect Books had a disappointing performance in an extremely challenging year, facing trading conditions that were significantly more difficult than anticipated, combined with investments and process changes that have taken longer than planned, both to implement and to return the anticipated benefits. The division made an underlying operating profit of £2.5m down 65.7%.

Coming after three years of progress and strong profit growth, this is a disappointing performance. We have implemented a clear recovery plan to address the short-term challenges and have now stabilised the business. A strengthened management team is being put in place, with a new leader of the business to drive performance forward.

# Specialist Services

**The Group's operating companies provide a range of specialist services for suppliers and customers which enhance the distribution of physical products. Our goal is to create an efficient and value adding proposition, tailored to the needs of our specialist markets.**

Investment in technology is central to the Connect Group offer. We operate some of the largest and most sophisticated customer information and marketing systems in our chosen industries. This gives a market insight which individual suppliers or customers cannot replicate. Our technology also supports added value services such as the efficient allocation of supplies, targeted product selection, returns processing and demand forecasting.

The specialist services we provide vary according to sector and customer need. We offer suppliers and customers a range of options which include: stockholding and product consolidation; multiple and complex product picking; returns processing; market data and forecasting, ultra time-sensitive distribution; track and trace technology.

# Industry Expertise

**Industry expertise is at the heart of our business model and competitive advantage.**

**The Group's key businesses are all acknowledged experts in their supply chains and are 'household names' in their respective industries. We have a long-term commitment to our industry sectors, investing in systems and infrastructure, which enhance our offer, while simultaneously supporting a partnership approach to success.**

Our skills, experience and market insight positions us as an integral part of our customers' supply chains and encourages a higher reward than might be typical of a more limited wholesale model of consolidation and distribution. Furthermore, by working across our supply chains we are able to deliver even greater efficiencies and share the benefits with customers and suppliers.

Track and trace technology
Ultra time-sensitive distribution

One stop shop
Business to business and consumer

Range management and promotion
Multi-channel sales and ordering

Over £40m technology investment supporting unique market insight

Over 4m books in stock available to retailers, libraries and consumer

Over 40,000 products in stock for schools, nurseries and care homes

# Business model

**Connect Group PLC is a leading specialist distributor, which delivers market-leading services to a range of carefully chosen markets.**

**The Group operates in large and complex markets which favour the role of a specialist distributor, adding value through bespoke services and industry expertise.**

**Since 2006 the Group has diversified and broadened its interests by making acquisitions in specialist distribution markets and developing new revenue streams which leverage our skills and competencies.**

## Chosen Markets

**Our chosen markets are characterised by having a relatively large number of suppliers, a complex to manage product range, and a diverse and dispersed customer base. This combination of customer and product fragmentation supports the role of an industry specialist. We apply industry expertise to reduce complexity and provide an efficient and timely distribution service.**

Our unique industry expertise and cost efficiency programme cements our relationship within these markets and positions us as the natural service provider of choice to industry stakeholders and thereby encourages long-term partnership arrangements.

Many of the Group's markets operate with long-term supplier and customer contracts, enabling investment in bespoke services which further enhance the position of our businesses in their supply chains.

| | Customers |
|---|---|
| Connect News & Media | 30,000 |
| Connect Books | 8,200 |
| Connect Education & Care | 30,000 |

The Group has a comprehensive risk management framework which has been further strengthened during the year with a consistent approach in identifying, assessing and reporting on risk and controls embedded across the Group. The Board is responsible for the Group's strategy and system of controls and risk management and undertakes an annual review of the Board's risk appetite. The Audit Committee annually reviews the effectiveness of the Group's internal controls and risk management system and reports its findings to the Board.

| | Change in risk v. FY13 | Potential impact | Mitigating actions and assurance |
|---|---|---|---|
| | Risk remains the same as in FY13/14. | Sales decline in newspaper and magazines are worse than expected (3%–5% range) and/or the Books market is impacted, each resulting in lower profit and negative market sentiment related to printed media. | A consistent pattern and clear view of market volumes ensures more accurate forecasting and combines with an expectation of continued declines for newspapers and magazines. Management continue to identify efficiencies to compensate for market declines. The Group's diversification strategy seeks to protect it from overexposure to individual market risks. |
| | Risk remains the same as in FY13/14. | Sales and profits expected from growth initiatives may not be met and/or contribution on growth initiatives impacts performance of base businesses. | A strong pipeline of growth and investment opportunities are reviewed by individual business teams, Group Executive and/or PLC Board depending on their size and potential impact on the Group. Financial and operational metrics are considered along with risk assessments and impact on management before decisions are made. |
| | Risk updated to reflect changes leading up to an election impacting discretionary spend. Impact and likelihood remain the same. | Reductions in discretionary spending may impact sales of newspapers, magazines and books with reductions in Government spending potentially reducing consumables budgets in schools. | Annual budgets and quarterly forecasts set realistic expectations internally and externally allowing for or changing objectives to meet short and medium-term financial targets. Management has a track record of delivering revenues and efficiencies to compensate for market impacts. |
| | Risk remains the same as in FY13/14. | Impact on supply of product or route to market may erode margin and/or increase cost to serve. | In Smiths News, five-year contracts with publishers support the market structure. Bertrams and The Consortium both operate in very fragmented markets with fewer significant suppliers or customers. Strong relationships across the supply chain help the Group to understand and demonstrate its strengths for the benefit of its suppliers and customers. |
| | Increasing competitive activity in the market place impacting both Connect Books and Connect Education & Care. | Sales growth opportunities are reduced and/or margin is eroded from price discounting required to hold market share. | Market scale and expertise provides the ability to offer value and service to customers. Bertrams and The Consortium monitor and track propositions to ensure competitive positioning. |
| | Increasing exposure to cyber crime as hacking becomes more sophisticated and increasing reliance on system driven solutions. | Customer service and/or satisfaction could be adversely impacted leading to compensation, increased costs for rectification and/or increased future investment requirements. Increased risk of penalty through breach of regulation such as the Data Protection Act. | External specialist advice supports a new internal position with the responsibility for reviewing the Group's exposure, measuring effectiveness of existing controls and recommending new controls if required. Controls further enhanced through implementing a robust Security Governance Framework, establishing a Vulnerability Management solution and further strengthening of the Security Architecture and process landscape. Continuous monitoring of regulatory requirements to ensure central compliance and guidance communicated out to divisions on changes when required. |
| | Increasing competitor activity and complexity of new markets combined with deterioration in Connect Books performance. | Sales and profits expected from acquisitions may not be met and/or reputation of the business and support for future acquisitions are questioned. | Financial and operational metrics are considered along with risk assessments and impact on management before decisions are made. Performance to plans are reviewed monthly with post investment analysis producing a more thorough review of each acquisition within 12 months after completion. |
| | Risk remains the same as in FY13/14. | Increased number of employees increases the cost base and potentially creates greater redundancy costs from future efficiency programmes. | Contractors have clearly articulated agreements defining tasks they are contracted to provide to Smiths News. Regular checks are carried out by the internal audit team across the Smiths News network to ensure understanding and compliance. |
| | Increasing complexity in markets and changing working practices increases risk of fraud and ineffective controls. | Risk of poor controls over debtors and stock could result in fraud, direct loss or reduced profits. Key financial assumptions budgeted for pension, interest and tax could move adversely reducing expected profits. | Strong operational processes are supported by a Group accounting policies manual to ensure appropriate financial controls are consistently applied. In addition, insurance is taken out to cover the Group from major risks. Annual budgets and quarterly forecasts set realistic expectations internally and externally allowing for or changing objectives to meet short and medium-term financial targets. |
| | Risk remains the same as in FY13/14. | Costs could increase through additional security requirements and/or penalties with severe reputational damage potentially causing the loss of contracts for our media business. | External security advice supports internal staff to review DMD's exposure, measure effectiveness of controls and recommend new controls if required. In addition, insurance is taken out to cover the Group from major risks. |
| **New** | Increasing reliance on centralised solutions and complex operating processes increases risk of single point of failure and need for robust Disaster Recovery and Business Continuity Planning procedures. | Trading capability, customer experience and sales/ margin performance impacted through inability to operate due to systems outages. | Significant investment undertaken by the organisation to provide Disaster Recovery capability across the Group for all essential systems. External expertise used to provide guidance and a Disaster Recovery facility. In addition a programme led centrally by the Group ensures Business Continuity Planning procedures and standards are embedded across the divisions. |
| **New** | Business is facing significant change with movement into new markets, heavy reliance placed on Executive and experience to manage/ guide this change. | Loss of key skills and leadership impacts the capability of the Group to deliver its strategic goals. | Performance and capability management processes in place, reviewed by the Remuneration Committee and Group Executive. Succession planning for critical roles and development plans for key individuals reviewed by the Nominations Committee. |

# Risk management

## The Group has a well-established risk management framework with in-depth risk assessment, reporting and monitoring processes in place.

**Risk management process**
The Internal Risk Committee for each business is responsible for monitoring the nature and extent of the risks across the business and conducts a half-yearly risk assessment based on identified business objectives. Risks identified across the risk universe are consolidated, refined and calibrated to each area of the business with support from the Head of Internal Audit. Principal risks are plotted on risk maps with description and owners recorded in the risk register. The Group Executive team review and monitor the Group's summarised risk map and register before final presentation to the Audit Committee on a quarterly basis. In addition, the risk map and risk registers of each of the three main businesses, Connect News & Media, Connect Books and Connect Education & Care, are separately reviewed by the managing director of each business with the Audit Committee annually.

The Group's principal risks are detailed over showing movement in risks as recorded last year.

**Connect Group PLC Board**
Overall responsibility for maintaining sound risk management and internal control systems.

**Audit Committee**
Audit Committee oversee framework of internal controls and risk management.

**Group Executive Committee**
Group Executive Committee review of summarised risk map and register.

**Business Units**
Risk management embedded through all business units.

**News & Media** **Books** **Education & Care**

**Corporate and Functional Department Risks**
Detailed risk assessments at all department levels.

### Principal risks

Structural market changes are deeper/ quicker than predicted, including print migration to digital.

Failure to identify new organic opportunities or new acquisitions required to meet growth targets.

Uncertainty of Government policy initiatives could adversely impact current business performance.

Major supplier or customer loss or consolidation changes the wholesale relationship.

Competitive environment becomes more challenging.

Failure to prevent cyber attacks that cause disruption or loss of systems and/or commercially/employee sensitive data.

Failure to deliver business plans and financial returns on recent acquisitions.

Legislative changes or interpretation impacting the engagement of delivery contractors resulting in an increase in the number of employees.

Financial risk and exposure through fraud, poor management controls and/or fluctuating key financial assumptions.

Failure by DMD to prevent breach of airside security causes disruption or loss.

Increasing reliance on centralised system solutions and complex operations are not supported by robust enough Business Continuity Planning & Disaster Recovery solutions to prevent disruption outside of expected tolerances.

Loss of key executives and subsequent loss of knowledge and skills impacts current and future business performance.

**Objectives for FY2014/15**

## Deliver profitable top line growth

- Increasing profitability by winning new customers, renewing existing contracts and regularly reviewing the profitability of products and services we supply.
- Securing sustainable cost efficiencies that are compatible with our service commitments and marketplace strategies.
- A carefully targeted acquisition strategy focusing on complementary markets, which enhance and leverage the skills and competencies of the Group.
- Grow new revenue streams, with a particular focus on expanding ventures launched in 2014.

## Develop digital and online propositions

- Continuing to invest in digital propositions that enhance our customer offer and provide both competitive advantage through service improvement and efficiency gains.
- Further growth of Wordery in UK and international markets; increasing the share of Wordery sales achieved through its bespoke website, Wordery.com.
- Developing the e-commerce capability of the News & Media and Education & Care divisions.
- Maximise productivity and efficiency gains from the introduction of new supply chain technology across all our divisions.

## Identify and secure further acquisitions

- Identify and pursue opportunities to acquire businesses in new but complementary specialist distribution markets.
- Secure further acquisitions that complement our existing businesses adding scale and capability in our existing markets.
- Ensure the rapid integration of new businesses, exploiting synergies and maximising value.
- Acquisitions will be pursued as and when the timing is right for the Group.

## Deliver further efficiencies across the Group

- Implement management action plans to improve the profitability, efficiency and productivity of the Books division.
- Achieve in full the three-year target of £20m annual cost savings in Smiths News by 2015. Identify and develop clear plans for sustainable cost reduction beyond 2015 of circa £5m p.a.
- Continue to optimise the cost base of our divisions and central Group services through ongoing process review.

## Invest in new processes and information systems

- Maintain our competitive advantage in the application of industry leading technology.
- Innovate to achieve further service and cost leadership which deliver benefits to the Group but also across our supply chains.
- Developing our information systems and business intelligence to better understand and respond to customer needs and market dynamics.
- Continued investment in our distribution networks to ensure we optimise the size, quality and location of our distribution centres.

## Maintain competitive advantage through our people

- Embedding the Connect Group Values across our existing and any newly acquired businesses.
- Investing to ensure we recruit, retain and develop the right people – supporting them in their career aspirations and providing opportunity for personal growth.
- Improving the speed and quality of communications with staff; implementing a business-wide 'team talk' programme which encompasses regular briefing and local action planning; encouraging a forward looking, and growth orientated culture.
- Maintaining our investment in key individuals and leadership roles which are crucial to our success and future capability.

# Progress against our strategic goals

| Objectives for FY2013/14 | Progress 2013/14 |
|---|---|
| **Deliver top line growth**<br>– Continuing to grow our existing businesses profitability by winning new profitable customers, and supplying additional products and services.<br>– Supplementing organic growth with carefully targeted acquisitions – as and when timing is right for the Group. | – Revenues of £1,809m were unchanged on last year.<br>– Underlying profits grew in News & Media by 8.0% and Education & Care by 5.0%.<br>– Underlying profits declined in Books by 65%.<br>– Continued investment in new customer propositions including Dawsonera, SNapp and Education websites.<br>– Key customer contracts were won, renewed or extended in each of our divisions.<br>– There were no acquisitions made in the year but the Group remains alert to acquisition opportunities. |
| **Develop digital and online propositions**<br>– Investing £5m over the next three years in the digital proposition to academic customers, to enhance and maintain the Dawsonera platform.<br>– Growing Wordery sales and market share, including launch of Wordery.com.<br>– Further developing the websites and online ordering capability of The Consortium.<br>– Maximise productivity from new 'pick and pack' technology to support internet fulfilment at Bertrams. | – The Dawsonera platform was upgraded to enhance its capability and user experience. New versions were released for key overseas markets, including France, Spain and The Netherlands.<br>– Wordery sales grew by over 50%.<br>– Investment in websites across all divisions during 2014.<br>– The packline technology at Connect Books is now operating. |
| **Identify and secure further acquisitions**<br>– Secure further acquisitions that complement our existing businesses adding scale and capability.<br>– Ensure the rapid integration of new businesses, exploiting synergies and maximising value. | – No acquisitions were made in 2014.<br>– The businesses acquired in 2013 have been fully integrated into the Group and its divisional structure.<br>– The Group continues to review acquisitions and has a pipeline of potential opportunities, but will choose targets carefully against a rigorous evaluation criteria. |
| **Deliver further efficiencies across the Group**<br>– Optimise the cost base of all divisions through further operational efficiencies.<br>– Rapidly secure synergy and efficiency gains from new acquisitions.<br>– Maintain 'on track' progress to £20m cost savings in Smiths News by 2015. | – The Group continues to maintain a rigorous focus on costs and efficiencies.<br>– Acquisitions made in 2013 have been integrated and cost synergies secured.<br>– Achieved £6m of cost savings in Smiths News in 2014.<br>– On track to achieve three-year cost saving target of £20m by 2015.<br>– Ongoing efficiency programmes in Smiths News, targeting continued cost reduction over the medium-term. |
| **Invest in new processes and information systems**<br>– Further strengthen our customer propositions through service innovation and continuing investment in new processes and information systems for all key markets.<br>– Continued investment in our distribution network and in operational technology. | – Investment in information systems and websites across all divisions.<br>– Launch of SNapp – an interactive application for Smiths News' customers.<br>– Further investment in new warehouse facilities for News & Media and Education & Care.<br>– Investments to replace and upgrade the Group's data centre.<br>– Investment in voice activated picking technology for selected distribution depots. |
| **Maintain competitive advantage through our people**<br>– Maintain our investment in our staff, supporting an outward-looking growth-led culture.<br>– Further develop our talent strategy and related initiatives to ensure we attract and retain high quality individuals in key leadership roles. | – Development and launch of Connect Group Values, supported by drive to increase communication and engagement with staff.<br>– Review and refocusing of our talent strategy to ensure greater access to training and development for all.<br>– Implementation of 'My Learning' online learning portal.<br>– Refreshing and enlarging the development review process to improve the identification and retention of key talent.<br>– Continued investment in the Company's graduate and modern apprentice schemes. |

**Target**
To grow free cash flow each year.

**Description**
We aim to continue investing in our businesses to achieve profit growth, whilst being able to generate increasing free cash flow.

**Description**
All businesses within the Group make concerted efforts to maximise recycling opportunities. We work closely with waste and recycling companies to ensure we are doing all we can to reduce waste and recycle materials wherever possible. Over 99% of unsold newspapers and magazines are recycled. Recycling performance tables are circulated monthly and all locations are encouraged to further improve if possible.

**Target**
To deliver 50% of profits outside newspaper and magazine wholesaling by 2016.

**Description**
We aim to diversify our business into structurally growing markets to deliver growth in revenue, profits and returns to shareholders.

**Description**
Delivering products on time is a crucial part of service to our customers. On time delivery is measured daily and reported back to management teams internally and to our publisher, retailer and other partner clients.

### Staff engagement

# 67%

**Description**
Our Team Talk staff survey is run every year for staff to have their say and to give us feedback from all divisions – the independent engagement specialists Best Companies conducted the survey on our behalf.

**Target**
To reduce leverage each year towards 1.0x target prior to any new acquisitions.

**Description**
We aim to continue investing in our businesses to achieve profit growth and return cash to shareholders, whilst reducing our leverage ratio.

# Strategy and key performance indicators

## Our strategic aim is to deliver 50% of profits from activities outside of newspaper and magazine wholesaling.

The Group is planning to make progress in each of its business units, increasing or maintaining market share and profitability across all core markets. In support of divisional strategic priorities, the Group's medium-term strategic aims are to:

**Deliver top line growth**
by increasing our market share, winning new contracts and developing new products and services for our customer base.

**Develop digital and online propositions**
that will complement the greater share of our business which we anticipate remaining in print and physical products.

**Identify and secure further acquisitions**
that complement and enhance our existing businesses and allow us to enter new specialist distribution markets.

**Deliver further efficiencies across the Group**
by continuing our programme of cost control, and working hard to drive the best operational standards across the Group.

**Invest in new processes and information systems**
to further improve the standard of operational delivery and customer experience across all business units.

**Maintain competitive advantage through our people**
supporting staff with ongoing training and development at every level.

## Achieving our strategic aims will deliver growing and sustainable shareholder returns.

**Target**
To grow revenue on an average five year compound rate.

**Description**
We aim to combine organic growth and acquisitions to offset the expected reduction in newspapers and magazines.

**Target**
To grow EPS in line with underlying profit growth.

**Description**
We aim to return value to shareholders by growing EPS in line with underlying profit growth. Underlying basic EPS is used as a metric to calculate executive incentivisation. See page 62.

**Target**
To grow underlying profitability each year.

**Description**
We aim to grow profitability by combining top line revenue growth, delivering efficiencies and acquisitions.

The Group annual bonus scheme is linked to underlying PBT. See page 62.

# A new brand, same great service

**In April 2014 the Group rebranded from Smiths News PLC to Connect Group PLC.**

The new name describes what we do best – connecting suppliers with customers, using our skills and technology to offer a compelling proposition for our chosen markets. It also reflects our ambition to diversify, entering new sectors with opportunity for growth.

When the Group was formed in 2006, it operated solely in the newspaper and magazine wholesaling sector. Today, Connect Group PLC has interests in News, Books, Education, Care and Specialist Media; we reach across the UK and internationally, and we're ambitious to extend and diversify our interests further.

Under the Connect Group identity our three divisions combine a range of powerful brands and businesses. Our leading businesses are household names in their supply chains – they are united by a commitment to service and a reputation for delivery that makes them leaders in their field.

Strategic Report

# Chairman's statement

# Delivering strong results

The Group has delivered a solid result despite a disappointing performance by our Books division. Overall, Group underlying profit before tax is broadly flat and underlying earnings per share has increased by 2.8%, with the performance of our News & Media and Education & Care divisions compensating for the poor trading in our Books division. Our strategy remains on track and we have plans for further diversification that will enhance the Group and provide more opportunities for growth.

In April 2014, we rebranded from Smiths News PLC to Connect Group PLC, a change which more clearly reflects our broader business and its sense of purpose and values. Since becoming an independent PLC in 2006 we have expanded our core businesses and diversified into carefully chosen sectors that leverage our skills and assets. Connect Group is now a multi-channel specialist distributor, connecting suppliers and customers in a range of large and complex markets. Our overall progress since 2006 has been pleasing and we remain ambitious to grow further as a broader based business.

The Group's operating companies compete in many different markets but they are united by the common challenge of meeting supplier and customer needs in an efficient, timely and targeted way. They all have market expertise that is widely acknowledged in their industries, making them central to the supply chains in which they operate. Our strategy has been to invest in people, systems and infrastructure – continually providing a competitive difference that underpins the long-term partnerships on which our respective businesses are founded.

The News & Media division demonstrates these qualities every day of the year. Its operation never stops, nor ceases to evolve and the winning of new contracts and renewal and extension of existing contracts through to 2019, from publishers representing 84% of our newspaper and magazine revenue, is a clear demonstration of the division's position in its markets. We have continued to introduce new and better solutions to what is already a complex and demanding service. This gives us confidence in our plan to find products and services that will complement our distribution network. The Jack's Beans coffee initiative is underway and the recently announced launch of Pass My Parcel, a time sensitive 'click and collect' service is an exciting development, indicative of the clear potential of this ever adapting operation. While it is still early days, these are positive steps in our strategy to find complementary revenues that compensate for the impact of reducing newspaper and magazine volumes over time and utilise our news distribution assets. Our specialist Media operations continue to make progress with new contracts for both print and digital customers, and there is much scope for growth.

This year the Books division has suffered from a combination of challenging markets, a change in product mix which impacted margins and subsequently our ability to remove variable costs at a sufficiently fast pace, and from a slower return than anticipated on the investments we have made. We are determined to find solutions which balance the need for sustainable recovery with continued support for investments that will enhance longer term opportunities. We will need to continue to address issues but the market as a whole remains large and we believe there are opportunities for a specialist such as Connect Books to grow in targeted sectors. A strengthened management team, including a new leader of the business, is being put in place, and we will seek to further improve performance in the year ahead, as part of a sustainable recovery.

Our Education & Care division has performed well in its education markets. The underlying characteristics of these markets remain strong and our strategy to continue investing in a market centric proposition is helping us win customers and increase our share of their overall spending. It is pleasing to see expansion into Scotland and Northern Ireland and the growth in academy groups can only be beneficial to an independent supplier to the education sector. Sales to care homes were down, reflecting an increasingly competitive market and we will be refreshing our offer for this customer group in the year ahead. In contrast, the performance of our Early Years sector is a clear highlight and demonstrates the potential of a well-targeted offer to a market that is in strong demographic growth.

Turning to the Group's financial performance, underlying profit before tax of £50.0m was up £0.1m and underlying earnings per share increased by 2.8% to 21.7p. Free cash flow increased by 14.1% to £37.2m (FY2013: £32.6m). The Board is committed to maintaining its dividend policy and thus a final dividend of 6.6p has been proposed, making a full year dividend of 9.7p up 4.3% on last year.

Our performance this year has shown the resilience of the diversified Group. Conditions across our markets were more mixed than in recent years. I know the management teams have pulled together to provide support and expertise as befits a cohesive group. This is characteristic of all of our people throughout Connect Group, who deliver results every day and without whom our progress would not have been possible. I would like to thank them for their efforts and acknowledge the leadership of Mark Cashmore and the Executive Team in steering the business through a challenging year.

My thanks also extend to my colleagues on the Board; I am grateful for their support and constructive challenge. In the year ahead, I will be approaching nine years of service, as will John Worby and Anthony Cann. A process to refresh the Board and its committees is underway, including in the first instance, a search for my successor. This will help to bring new insight, diversity and expertise to the Board that is relevant to the Group's ambitions.

In summary, the Group has delivered a resilient performance and remains focused on achieving its strategic ambitions. We have exciting plans for the future and we look forward to reporting on progress in the year ahead.

**Dennis Millard**
Chairman

# Highlights 2014

| | |
|---|---|
| Group revenue **£1.8bn** +0.1% | |
| Underlying PBT **£50.0m** +0.2% | |
| Free cash flow **£37.2m** +14.1% | |

- **Strong performance in two divisions, representing over 90% of Group profit**
- **Good shareholder returns through EPS and DPS growth**
- **Exciting new organic opportunities supporting diversification strategy**
- **Maintaining ambition to grow profits from activities outside of newspaper and magazine wholesaling to 50%**

## Contents

# Our business at a glance

**As at August 2014, the Group had combined revenue of £1.8bn and generated underlying operating profit of £50.0m. Employing over 4,000 staff, operations are predominantly UK based with smaller representation and sales worldwide.**

**Connect Group PLC is a leading specialist distributor operating in large and diverse markets. The Group has three separate divisions, connecting suppliers to customers in an efficient, knowledgeable and service oriented way.**

To find out more about Connect Group PLC please visit www.connectgroupplc.com

## Connect News & Media

Encompassing: Smiths News, the UK's largest news wholesaling business with an approximate 55% market share, distributing newspapers and magazines on behalf of all the major national publishers as well as a large number of regional publishers. Smiths News serves approximately 30,000 customers across England and Wales, supplying large general retailers as well as smaller independent newsagents.

Dawson Media Direct is an international media business, supplying newspapers, magazines, inflight entertainment technology and content to over 80 airlines in 50 countries.

## Connect Books

Combining a number of recognised brands in print and digital bookselling, including Bertrams, Dawson Books and Wordery. A leading distributor of printed and digital books, the division serves over 8,200 customers in approximately 100 countries, with over 200,000 in stock titles and access to over a further 7m consumer and 20m academic titles.

## Connect Education & Care

A leading independent supplier of consumables through The Consortium and West Mercia Supplies with an approximate 5% market share. The division serves over 30,000 customers with an extensive range of over 40,000 products across a branded, own brand and value range, including stationery, arts and crafts and cleaning.

## Performance by divisions

# Connecting customers & suppliers

**Connect Group PLC**
Annual Report and Accounts
2014

**Company No: 5195191**

## SECTION 30 COMPANIES ACT 2006

## COMPANY LIMITED BY SHARES

## RESOLUTIONS OF CONNECT GROUP PLC

At the Annual General Meeting of the Company duly convened and held at:

Rowan House, Cherry Orchard North, Kembrey Park, Swindon, Wiltshire, SN2 8UH

on 4 February 2015

The following resolutions were duly passed:

**ORDINARY RESOLUTION**

**Resolution 15:** to resolve that:

(a) the directors be authorised to allot shares in the Company or grant rights to subscribe for, or convert any security into, shares in the Company:

  (i) in accordance with Article 7 of the Company's Articles of Association, up to a maximum nominal amount of £3,158,005 (such amount to be reduced by the nominal amount of any equity securities (as defined in Article 8 of the Company's Articles of Association) allotted under paragraph (ii) below in excess of £3,158,005); and

  (ii) comprising equity securities (as defined in Article 8 of the Company's Articles of Association), up to a maximum nominal amount of £6,316,010 (such amount to be reduced by any shares allotted or rights granted under paragraph (i) above) in connection with an offer by way of a rights issue (as defined in Article 8 of the Company's Articles of Association);

(b) this authority shall expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution or, if earlier, at the close of business on 29 February 2016 (save that the Company shall be entitled under such authority, pursuant to Section 551(7) of the Companies Act 2006, to make any offer or agreement prior to expiry of such authority which would or might require shares to be allotted or rights to be granted on or after such expiry); and

(c) all previous unutilised authorities under Section 551 of the Companies Act 2006 shall cease to have effect (save to the extent that the same are exercisable pursuant to Section 551(7) of the Companies Act 2006 by reason of any offer or agreement made prior to the date of this resolution which would or might require shares to be allotted or rights to be granted on or after that date).

**SPECIAL RESOLUTIONS**

**Resolution 16:** to resolve that:

(a) in accordance with Article 8 of the Company's Articles of Association, the directors be given power to allot equity securities for cash;

(b) the power under paragraph (a) above (other than in connection with a rights issue, as defined in Article 8(b)(ii) of the Company's Articles of Association) shall be limited to the allotment of equity securities having a nominal amount not exceeding in aggregate £473,700;

(c) this authority shall expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution or, if earlier, at the close of business on 29 February 2016; and

(d) all previous unutilised authorities under Sections 570 and 573 of the Companies Act 2006 shall cease to have effect.

**Resolution 17:** to resolve that, pursuant to Section 701 of the Companies Act 2006, the Company be and is hereby generally and unconditionally authorised to make market purchases (as defined in Section 693(4) of the Companies Act 2006) of any of its own ordinary shares in such manner and on such terms as the directors may from time to time determine provided that:

(a) the maximum aggregate number of ordinary shares authorised to be purchased is 18,948,033;

(b) the minimum price which may be paid for each ordinary share is 5p (exclusive of all expenses);

(c) the maximum price which may be paid for each ordinary share is an amount (exclusive of all expenses) equal to the higher of:

    (i) 105% of the average of the middle market quotations for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is purchased; and
    (ii) the price stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation 2003;

(d) the authority shall, unless previously varied, revoked or renewed, expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution or, if earlier, at the close of business on 29 February 2016, save that the Company shall be entitled under such authority to make at any time before such expiry any contract or contracts to purchase its own shares which will or might be executed wholly or partly after such expiry and make a purchase of shares in pursuance of any such contract or contracts; and

(e) all existing authorities for the Company to make market purchases of ordinary shares are revoked, except in relation to the purchase of shares under a contract or contracts concluded before the date of this resolution and which has or have not been executed.

**Resolution 18:** to resolve that a general meeting of the Company, other than an Annual General Meeting, may be called on not less than 14 clear days' notice, provided that this authority shall expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution.

Signed:..........................................

Stuart Marriner
Company Secretary
4 February 2015