Making partnerships work

Mears Group PLC
Interim Report 2015

Providing partnerships through our depth and breadth of services.

At Mears, we are addressing some of the biggest challenges our country faces: quality social housing, building communities and providing exceptional care.

In partnership with our Social Housing clients, we maintain, repair and upgrade the homes of hundreds of thousands of people in communities from remote rural villages to large inner-city estates.

Our Care teams provide support to over 30,000 people on a daily basis, enabling older and disabled people to continue living in their own homes.

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Highlights

Financial highlights

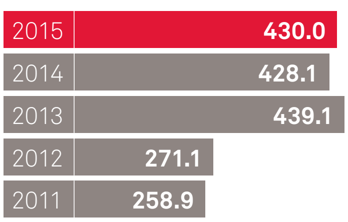
- Profit before tax* of £19.2m (2014: £18.7m), growth of 3%
- Improved operating margins of 4.9% (2014: 4.7%) driven by Social Housing
- Excellent EBITDA cash conversion for the twelve months to June 2015 of 92% (2014: 100%)
- New contract wins in excess of £220m (2014: £201m):
  - Social Housing awards of £185m with a win rate on competitively tendered works of 33% (2014: £135m and 35%)
  - Care awards of £35m with a win rate of 60% (2014: £66m and 63%)
- Strong balance sheet with net debt at 30 June 2015 of £4.2m (2014: net cash £2.7m); average net debt of £69.0m (2014: £63.0m)

Review of the period

Financial statements

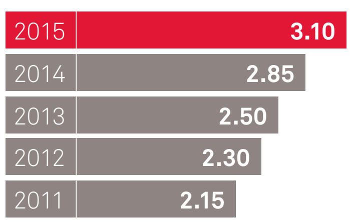
Total Group revenue (continuing) (£m)

£430.0m



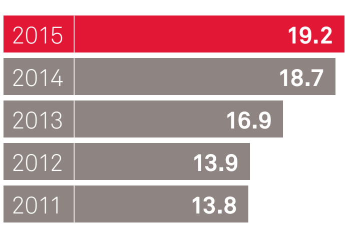
Interim dividend per share (p)

3.10p



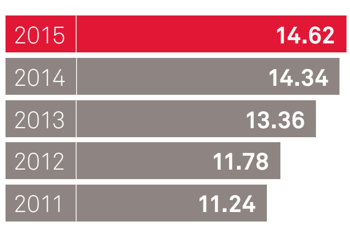
Profit before tax (continuing) (£m)*

£19.2m



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

14.62p



* Stated before amortisation of acquisition intangibles. The normalised diluted EPS measure is further adjusted to reflect a full tax charge.

Mears at a glance

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

Social Housing

Our clients are increasingly looking for partners who can operate strategically as well as operationally across a range of housing services. Mears has extended its core reactive and planned maintenance offering to include housing management to support clients in delivering more integrated solutions, aligned to their strategic challenges.

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

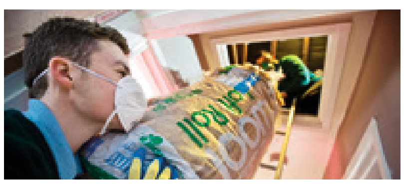
2014 annual revenue	Employee numbers	Office locations
£715m	c.5,600	180

Our breadth of services:

Repairs

Estate management

Planned and cyclical maintenance

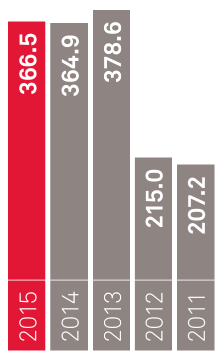


Fuel poverty initiatives

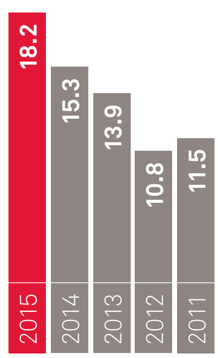
Grounds maintenance

Capital projects

Revenue (£m)



Operating profit (£m)



Our customers:

- Local Authorities
- Registered Social Landlords
- Private Landlords
- Tenants and service users
- Community groups

We provide personal care to over 30,000 elderly and disabled people in their own homes, on a daily basis.

Care

We have a comprehensive range of domiciliary care and complex care services enhanced by our ability to deliver a range of housing adaptations and assistive technology, such as telecare. The range of services enables us to deliver broad solutions to the independent living challenges faced by so many elderly people, as well as younger people with physical or mental disabilities.

We provide high quality and flexible care for older and disabled people who want to continue living in their own homes.

2014 annual revenue
£124m

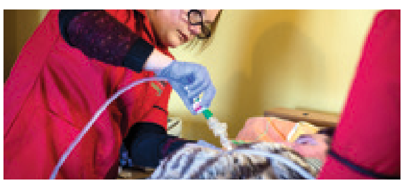
Employee numbers
c.11,400

Office locations
130

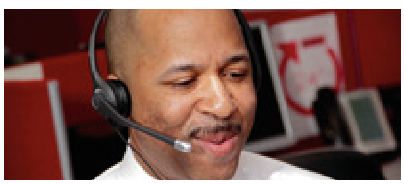
Our breadth of services:

Independent living service

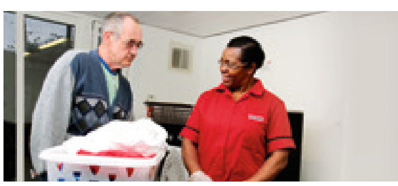
Aids and adaptations



Complex care



Assistive technology (telecare)



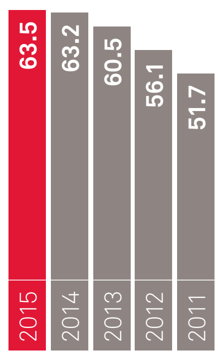
Live-in care

Extra care

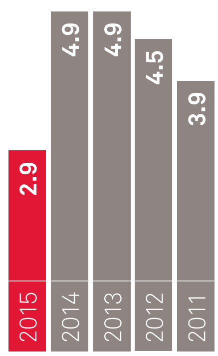
Our customers:

- Local Authorities
- NHS
- Charities
- Community groups
- Elderly people
- People with learning and physical disabilities

Revenue (£m)



Operating profit (£m)



Business review

We continue to place great emphasis on winning high quality contracts that provide clear and sustainable margins with good cash flow dynamics. Our dedication to providing our clients with first class service and value remains undiminished.

Summary of interim period

Financial highlights

- Profit before tax* of £19.2m (2014: £18.7m), growth of 3%.
- Improved operating margins of 4.9% (2014: 4.7%) driven by Social Housing.
- Excellent EBITDA cash conversion for the twelve months to June 2015 of 92% (2014: 100%).
- New contract wins in excess of £220m (2014: £201m):
  - Social Housing awards of £185m with a win rate on competitively tendered works of 33% (2014: £135m and 35%).
  - Housing Management awards of £85m.
  - Care awards of £35m with a win rate of 60% (2014: £66m and 63%).
- Strong balance sheet with net debt at 30 June 2015 of £4.2m (2014: net cash £2.7m); average net debt of £69.0m (2014: £63.0m).

Social Housing division

- Revenue of £366.5m (2014: £364.9m).
- Operating margin of 5.0% (2014: 4.2%), reflecting continued margin improvement driven by efficiencies from former Morrison contracts and sales mix moving towards higher margin Housing Management activities.
- Continuing high levels of customer satisfaction.
- Strong period of business development in Housing Management.
- Hiatus in maintenance contract opportunities coming to an end.

Care division

- Revenue of £63.5m (2014: £63.2m).
- Operating margin, before the impact of the Care UK Care at Home business (CAH), of 5.8% (2014: 7.8%), reflecting significant investment in carer pay and impact of new contract mobilisations.
- Continued strong regulatory compliance.
- The acquisition of CAH significantly increases the scale of Mears within the domiciliary care market, now the second biggest provider in the UK.

Outlook

- Order book at £3.2 billion (2014: £3.7 billion), reflecting the short-term delay in new bidding opportunities over the last twelve months.
- Bidding opportunities in the longer term expected to remain at historical levels.
- Visibility of 96% of consensus forecast revenue for 2015 and 85% for 2016 (2014: 95% and 85%, respectively).

* Stated before amortisation of acquisition intangibles.

Bob Holt
Chairman

David Miles
Chief Executive Officer

We are pleased to announce solid interim results for the six months ended 30 June 2015.

The headline financials, which are in line with our expectations, are detailed below:

- Revenues show a small increase to £430.0m (2014: £428.1m), which reflects the quiet period of new contract bidding in Social Housing, combined with a Care sector where revenues, in the short term, continue to be constrained by client budgets together with the challenge of recruitment. The momentum in both our core sectors is increasingly positive and will be discussed in greater detail in this Interim Report.
- Operating margins at a Group level reflect continued improvement, increasing to 4.9% (2014: 4.7%).
  - The Social Housing operating margin increased to 5.0% (2014: 4.2%), driven primarily by the improving contract margins being generated from the ex-Morrison business together with a changing sales mix towards higher margin Housing Management services. The margin in both 2015 and 2014 is also assisted by a reduced number of new contract mobilisations, which are typically loss making in their first six months. We remain on target to achieve a full-year Social Housing margin of around 5.3% (FY 2014: 4.8%).
  - The Care operating margin was reduced to 4.6% (2014: 7.8%). The underlying Care operating margin reduced from 7.8% to 5.8%, reflecting the diluting impact from organic reduction in revenues and a continued investment in our Care workforce combined with an intensive period of new contract mobilisations. In addition, the result from the newly acquired Care UK Homecare Limited (CAH) was an operating loss of £0.5m, which was in line with our expectations.
- The net finance charge increase to £1.2m (2014: £0.5m) reflects reduced finance income following tightening pension assumptions. The underlying interest charge on overdraft and loans is unchanged.
- The margin improvement delivered an increased profit before tax and amortisation of 3% to £19.2m (2014: £18.7m). Diluted earnings per share increased 14% to 11.16p (2014: 9.75p). Normalised diluted earnings per share, which shows earnings before amortisation of acquisition intangibles and reflects an 18% tax charge, was up 2% to 14.62p (2014: 14.34p).

- The integration of CAH, following its acquisition in late May 2015, remains in line with our original plan.
- We have continued to deliver solid cash flows, with cash generated as a proportion of EBITDA at 92% for the rolling twelve-month period to 30 June 2015 (2014: 100%). Average net debt for the half-year period was £69m (H1 2014: £63m, FY 2014: £70m), demonstrating continuing solid cash management.
- The Group has reported all transactions within normal trading. In particular, the trading losses and the costs of integration following the acquisition of CAH have been presented within the Group's headline financial measures. It remains the Board's strong preference to keep normalising adjustments to a minimum, notwithstanding the short-term impact to earnings.
- We have 96% visibility of consensus forecast revenue for the current year and in excess of 85% for 2016.

The Board is declaring an interim dividend of 3.10p per share, payable on 3 November 2015 to shareholders on the Register of Members on 16 October 2015. This represents an increase of 9% (2014: 2.85p) and reflects the Board's ongoing confidence in the Group's future prospects.

Social Housing

Service quality remains a key differentiator; we are pleased that our Social Housing division continues to achieve high standards of service delivery.

The Social Housing business has continued to deliver a solid performance with revenues of £366.5m (2014: £364.9m). Whilst the performance at an aggregate level appears relatively flat, the movements within the individual components are relevant and detailed below:

Revenue stream	Commentary
Maintenance	
Day-to-day, Housing Revenue Account (HRA) funded, non-discretionary, maintenance spend H1 2015 revenue: £294m (H1 2014: £309m, H2 2014: £288m)	The changes to housing finance in 2012 had a positive impact on the level of funding within the ring-fenced HRAs of Registered Social Landlords (RSLs), providing additional opportunities to generate income. A large proportion of RSLs are reporting large surpluses, which we see as positive. As previously reported, these changes resulted in a short-term delay in bidding opportunities with activity at a low level in both 2014 and 2015. This has resulted in a reduced number of new contract mobilisations during this time. The expiration of a number of contracts during 2014 which have not, at the half-year stage, been fully replaced in 2015, resulted in a small reduction in revenues when comparing H1 2015 with H1 2014. On a sequential basis, H1 2015 delivered 2% growth on H2 2014. On a positive note, it was previously anticipated that three of the Group's flagship maintenance contracts would come up for rebid during 2015; all three have been similarly impacted by these delays and have been extended. Whilst the recent announcement to reduce social rents by 1% p.a. for the next four years will have an impact on the income of RSLs, this change should be considered together with other measures that provide opportunities to increase income; overall the changes to housing finance over the last three years have been positive for RSLs. The recent change will inevitably require RSLs to review their business plans; however, we do not anticipate any overall negative impact to our revenues. We believe we are starting to come out of the quiet period for bidding with a number of new opportunities now at an advanced stage. We expect the bidding opportunities over the long term to remain at historical levels and our organic growth aspiration remains at 5–10% p.a.
Capital works, predominantly HRA funded H1 2015 revenue: £49m (H1 2014: £46m, H2 2014: £48m)	The benefits enjoyed by RSLs following the changes to housing finance similarly impact positively in respect of capital works opportunities. Whilst our main focus remains maintenance, we look to augment this with capital works opportunities. Our organic growth aspiration in this area is 5% p.a.
Fuel poverty H1 2015 revenue: £2m (H1 2014: £5m, H2 2014: £4m)	The Government continues to look for solutions to tackle fuel poverty and carbon reduction challenges in housing. However, since the Government's decision to spread the Energy Company Obligation (ECO) funding over more years, this area has reported reduced activity. Mears maintains a small team, typically targeting fuel poverty opportunities within our existing client relationships. For the avoidance of doubt, there is no impact to Mears in respect of the scrapping of the Green Deal; as we stated at the time of its introduction, this was never a solution for fuel poverty within Social Housing.

Business review continued

Social Housing continued

Revenue stream	Commentary
Housing Management	
Housing and property management H1 2015 revenue: £17m (H1 2014: £2m, H2 2014: £6m)	There are currently over 64,000 households, the vast majority housing families, who are legally homeless and being supported by Local Authorities. It is predicted that these numbers will increase over the next few years as more people become homeless and the supply of suitable accommodation reduces. The shortage of safe and secure housing is a significant challenge faced by Mears' clients today. We anticipate Local Authorities having increased responsibility to provide more social homes and remove the reliance upon those private landlords who provide properties which are not of a uniformly high standard. Mears provides a range of options for Local Authorities. The acquisition of Omega in October 2014 was a logical extension to the services provided within our Social Housing division and has materially enhanced our ability to work with housing providers to improve the delivery of housing and property management services. Through Omega, we acquired a business with annual revenues of circa £20m. This area of the business is likely to deliver growth in excess of 50% during its first year and provides the Group with significant growth opportunity over the short and medium term. Over time, we see Housing Management becoming entwined with our traditional Social Housing maintenance activities. Our conservative organic growth target in this area is to double this part of the business within the next three years.
Mears in-sourcing solutions H1 2015 revenue: £5m (H1 2014: £3m, H2 2014: £4m)	Our insourcing offering was developed in anticipation of an increase in the level of outsourced work being taken back in-house by Housing Associations following the VAT rate being increased to 20% and, given the restriction they suffer, upon the recovery of input VAT. Whilst the sector has seen a number of such transfers, they have typically been contracts of a small size. We see any further increase in the number of in-sourced solutions as an opportunity. This provides the opportunity to deliver higher margins with a low revenue and working capital requirement. In addition we provide a stand-alone 24/7 call centre service to a number of RSLs and we have recently extended this white-collar offering to income management and planning application administration.

Business development

The Social Housing division has secured new contracts of £185m, with a new contract win rate on competitively tendered works at its historical average of 33% (by value) (2014: £135m and 35%). Key to our success, now more than ever, is our ability to develop and deliver innovative solutions for our customers.

Whilst the quantum of new contract wins is relatively low, the short-term delay in new bidding opportunities has been widely communicated over the last twelve months. The bidding opportunities available to the Group over the longer term remain at historical levels. Our service delivery remains strong and we feel well positioned to benefit now that we are seeing the market improve.

Since the Group extended its services to Housing Management, accelerated by the acquisition of Omega in 2014, the Group has successfully grown the business with some 3,500 homes now under management across the country.

Our key offering is to work with RSLs, private landlords, investors and developers to create structures to provide and manage housing. Our not-for-profit Registered Provider enables us to offer our partners a regulated body which provides security and good governance. Mears is not a property developer or asset holder and will focus on managing assets for the benefit of owners, client public sector bodies and residents.

The private rented sector (PRS) in the UK has over nine million households renting as home ownership reduces. Many people are now choosing the PRS either because mortgages are seen as unaffordable or to provide the flexibility people require in a mobile employment market. Mears is seeking to provide high quality tenancy and asset management, giving tenants security and stable rents without punitive and unnecessary fees. Working with Local Authorities, Housing Associations and institutional investors, we are seeking to develop portfolios of good quality homes. In May 2015, working with a Local Government Pension Scheme, Mears coordinated the acquisition of 305 rented homes in the East Midlands. Rents will be kept below the full market with any increases protecting this affordability gap. Mears is engaged to provide marketing, letting and housing management services over a period of 20 years. This is typical of a large number of opportunities and we anticipate strong organic growth in our portfolio over the next twelve months.

In parallel with growing homelessness, there is a national need to build new homes for social, affordable rent. Mears, through its Registered Provider, is working with house builders and investors to bring forward stalled development sites where the affordable housing elements can be funded without grants to provide rented and shared ownership tenures.

This is an exciting, immature market with a significant disparity between supply and demand. Given the urgency for our clients to find solutions to ease the homelessness issue, the current opportunity pipeline is particularly buoyant. In the short term, our bid pipeline comprises a small number of strategically important bids.

Care

The Board is pleased with the progression of the Care division, mindful that the financial results do not properly reflect the momentum that is building in this area.

Prospects for the UK Care market over the long term remain very strong given the underlying growth drivers of an ageing population and the need to look after people in their own homes rather than in hospital or other residential settings. Domiciliary care will also benefit from greater integration of health and social care. The challenges facing the health and social care system are significant and require a change in the relationship with providers. Scale and capability are increasingly important. Scale is important as innovative commissioners look to partner providers around joint achievement of outcomes and a level of financial risk sharing – this is an approach Mears adopts within its Social Housing market and one which is now developing within Care, such as its contracts with Torbay and Wiltshire. Capability is important in terms of maximising the opportunities around looking after people with more complex conditions, often funded directly by the NHS and increasingly from pooled NHS and social care budgets.

The acquisition of CAH in May 2015 significantly increases the scale of Mears within the domiciliary care market, making Mears the second biggest provider in the UK. CAH provides an excellent geographic fit with Mears' existing Care business with limited cross-over. Moreover, the acquisition strengthens the Group's position with a number of strategically important client relationships which we believe have potential to develop into output-based contracts on re-tender. CAH has historically held one of the best track records of compliance with regulatory ratings amongst the national providers. While initial investment in CAH will be needed, the combination of capability and scale will make Mears a more attractive partner for the emerging, larger partnering-orientated contracts such as those already held by Mears in Torbay and Wiltshire.

The Care division reported revenues of £63.5m (2014: £63.2m), including £5.0m in respect of CAH. The underlying organic revenues reflect an 8% reduction compared to the comparable period in 2014 and a 4% reduction on a sequential basis when comparing to H2 2014. The primary focus for the revenue reduction remains the shortage of care workers and not a shortage of care work.

Social Care has seen a significant reduction in funding over the last few years, but these pressures have in turn created a momentum for change which is starting to support Mears' long-term vision for a more integrated and better commissioned range of services, delivered by a sustainable workforce. The recent Budget announcement regarding the new National Living Wage, while creating immediate financial pressures on Councils and Trusts, will also continue to encourage the development of a more outcome-orientated system that fits well with Mears' capabilities.

The Government's decision to delay reforms to social care funding demonstrates the apparent inability of successive governments to make headway on this issue. The postponement to the end of this parliament makes it almost certain that these reforms will not happen. The most critical consequence is that the money the Coalition Government had committed to find to pay for the reforms has been lost. There is no commitment to reinvest this money in social care; some £6 billion in total over the next five years. As things stand, the postponement adds not a penny to beleaguered Council care budgets. Instead the case for additional money for Social Care will have to start all over again in the autumn spending review. So, while the Government has set out a clear agenda and £8 billion of new investment for the NHS, its decision leaves it with no plan for social care. It underlines the compelling case for a single ring-fenced settlement for both the NHS and social care that recognises the interdependency of these services and the needs they meet. Social care is one of the main areas of spend for Councils and we have seen five years of spending reduction. While homecare has received more protection than most areas of Council spending, it has seen real reductions and a concentration of spend on those service users with the highest need.

Business review continued

Care continued

Within this framework of financial pressure we have seen some significant change:

- We have continued to win two out of three of the Care tenders we bid for; however, these bids have predominantly been for a single lead provider for a particular zone, as opposed to a previous practice of multi-provider framework contracts. The most advanced example of this is at Torbay, where we are the single provider for the whole geography, on a contract expected to grow to revenues of £10m p.a. We are extremely pleased with the positive start that we have had with this contract and see significant opportunity for future development. Following the positive start, we were almost immediately asked to take over a contract by the neighbouring Devon Council, giving us our first work with this commissioner. The pipeline of opportunities is also characterised by significantly fewer providers with longer-term contracts now typically three to five years in length. We have even seen a return to block contracting with some commissioners, notably with wins in Norfolk and Lincolnshire in the first half of 2015.
- Commissioners are now recognising the need to improve pay and conditions for staff. We have already seen charge rates over the last 18 months on our winning tenders rise by over 10% and we expect this trend to continue with the introduction of the National Living Wage. Mears has taken a long-term approach to this by investing significantly in care worker pay rates and developing more sustainable contracts, which is creating the workforce we need to deliver to long-term opportunities in the sector.
- Provider consolidation continues, including our own recent acquisition of CAH. In an increasingly regulated environment and the new requirements of the Care Act to more actively consider provider financial stability, scale and diversity of service is continuing to rise in importance. This is evidenced by the significant reduction in the number of providers per let contract. The initial mobilisation of CAH into Mears has begun well and has been well received by clients. As indicated, we will need to invest in improving some of the services and, in particular, carer pay and conditions and we are confident that this will prove to be an excellent acquisition for the Group. We also continue to look at other acquisitions that can further strengthen the Group.
- Greater integration between the NHS and Social Care is now an absolute necessity and is gathering pace, although we would still prefer this to be faster. The £5.3 billion Better Care Fund, which is the leading Government initiative to support NHS investment in community services, is felt by many to have not yet reached front line service delivery in the way intended. However, we do see an increasing range of opportunities here and have secured complex care/continuing health wins in locations such as Southampton, North Tyneside and Suffolk in the first half of 2015. Our Mears Nurseplus capability, offering a range of nursing-led services, has positioned us well here.

Looking at the first half of the year as a whole, we have secured £35m of contract wins at a win rate of 60% by value (2014: £66m and 63%).

In summary, the immediate environment for our Care services remains challenging but we continue to strongly believe we are the best placed provider to support and deliver the change needed in the sector and we remain very optimistic over the medium to longer term.

Balance Sheet

Strong working capital management has always been and remains a cornerstone of our business. Our internally developed IT systems have a strong financial focus and this is a driving force behind efficient cash management. The IT system is also central to the valuation of work in progress and amounts recoverable on contracts, ensuring that valuations are robust.

We are pleased to report a net debt position at 30 June 2015 of £4.2m (2014: net cash £2.7m) following conversion of 92% of EBITDA from continuing operations into cash over the rolling twelve-month period to June 2015 (2014: 100%). Whilst we are delighted with our good profit to cash conversion, a more important indicator remains the average daily net debt for the six-month period of £69.0m (2014: £63.0m). This small increase is pleasing given the Group incurred outflows of £20.0m in October 2014 in respect of the acquisition of Omega, together with a further £11.3m in May 2015 in respect of the acquisition of CAH. The average daily debt level gives a better indicator of our underlying requirement, as does the £1.4m (2014: £1.4m) bank interest (including the interest charge on interest rate swap) charged to the income statement.

Total shareholders' equity rose from £194.5m at 31 December 2014 to £202.1m at 30 June 2015. The increase in net assets is driven by retained profits.

Corporate governance and risk management

The Board continues to set itself high standards of corporate governance. Our Corporate Governance Report issued within our Annual Report 2014 detailed how we approach governance.

We have reviewed and updated the Group's risk register. The Senior Management Teams play a central role in reviewing and challenging the Group's risks. The Group risk team presented risk management training modules to all levels of management via the Group development programme to further increase our strong risk management ethos.

The key risks of the Group as at 30 June 2015 are those detailed within the Annual Report and Accounts for the year to December 2014 and remain unchanged.

Our people

We commend our employees for their commitment and energy throughout another significant period for the Group. We continue to be impressed by their quality, professionalism and loyalty.

Mears has a diverse workforce of over 17,000 staff and almost 400 apprentices; the vast majority live in the areas that they work. Diversity and respect for all is core to our induction programme and our training on recruitment and customer care.

We were delighted to be named as a Social Mobility Business Champion in recognition of the work that we do to actively promote opportunities to people living in areas of above average levels of disadvantage. Throughout 2015, we will be working with the Government and eleven of the UK's most high profile companies to develop a new benchmark for social mobility which builds on our existing work.

We continue to invest in the future generation. During the first half, Mears opened its new national training academy in Rotherham which will oversee the delivery of the Group's Learning and Development programme. The capability of Mears' existing in-house training function has been further enhanced through developing external partnerships with training providers. The Group is committed to providing the best technical training for our people, as well as creating training and career development opportunities, particularly for young people and the unemployed, within the communities in which we serve.

Our corporate strategy includes the establishment of an internal talent scheme which recognises the potential of our existing workforce and maximises the likelihood of retaining our most promising people. We have broadened this management development to cover senior leadership, branch manager and supervisory levels. These bespoke programmes call on internal experts and external specialists in order to create an effective scheme, combining the best of Mears with the latest in leadership thinking and wider-industry best practice. We focus on the enhancing and strengthening of skills in order to improve performance, as well as stretching delegates who have the potential to take on more senior roles in the future.

Positive outlook for the Group

We operate in robust and defensive markets where spend is largely non-discretionary. We continue to place great emphasis on winning high quality contracts that provide clear and sustainable margins with good cash flow dynamics. Our dedication to providing our clients with first class service and value remains undiminished.

We expect our Social Housing business to continue to grow through further contract wins. While we are market leader, we deliver services to circa 15% of the UK Social Housing stock which leaves us significant further growth opportunities given our differentiated market-leading position.

We see the development of our Housing Management services as an important extension of our Social Housing offering. The demand for affordable housing will provide opportunities to work with housing providers to improve the delivery of housing and property management services and to increase the supply and management of housing through innovation and partnership. Currently, this area is highly fragmented and under-developed. We believe the Group is well positioned to progress and deliver strong organic growth. Where appropriate, we will make acquisitions to develop the breadth of our services and enhance our scale.

We are confident that further opportunities in Care will grow from health and social care outsourcing and the implementation of new localised commissioning models. Consequently, we will continue to move further up the acuity chain, with an increased focus on organic growth, extending our Nurseplus model across our clients with this growth being supported by in-fill acquisitions.

We have had a good first half and we look forward to updating you with further successes over the course of the second half.

David Miles
Chief Executive Officer
david.miles@mearsgroup.co.uk

Bob Holt
Chairman
bob.holt@mearsgroup.co.uk

17 August 2015

Financial statements

Half-year condensed consolidated income statement

For the six months ended 30 June 2015

		Six months ended 30 June 2015		Six months ended 30 June 2014	
	Note	£'000	£'000	£'000	£'000
Sales revenue	3		**430,022**		428,071
Cost of sales			**(318,011)**		(315,781)
Gross profit			**112,011**		112,290
Other administration expenses		**(91,601)**		(93,071)	
Operating result before intangible amortisation	3	**20,410**		19,219	
Amortisation of acquisition intangibles		**(4,519)**		(4,750)	
Total administration expenses			**(96,120)**		(97,821)
Operating profit	3		**15,891**		14,469
Net finance charge	4		**(1,199)**		(512)
Profit for the period before tax			**14,692**		13,957
Tax expense	5		**(2,487)**		(3,976)
Profit for the period			**12,205**		9,981
Attributable to:					
Equity holders of the Company			**11,460**		10,185
Non-controlling interests			**745**		(204)
Profit for period			**12,205**		9,981
Earnings per share					
Basic	7		**11.28p**		9.89p
Diluted	7		**11.16p**		9.75p

Half-year condensed consolidated statement of comprehensive income

For the six months ended 30 June 2015

	Six months ended 30 June 2015 £'000	Six months ended 30 June 2014 £'000
Net result for the period	**12,205**	9,981
Other comprehensive income for the period		
Which will be subsequently reclassified to the Income Statement:		
Cash flow hedges:		
– gains/(losses) arising in the period	**151**	(43)
– reclassification to Income Statement	**243**	387
Decrease in deferred tax asset in respect of cash flow hedges	**(72)**	(79)
Which will not be subsequently reclassified to the Income Statement:		
Actuarial gain on defined benefit pension scheme	**—**	—
Other comprehensive income for the period	**322**	265
Total comprehensive income for the period	**12,527**	10,246
Attributable to:		
Equity holders of the parent	**11,782**	10,450
Non-controlling interests	**745**	(204)
Total comprehensive income for the period	**12,527**	10,246

Half-year condensed consolidated balance sheet

As at 30 June 2015

	Note	As at 30 June 2015 £'000	As at 31 December 2014 £'000	As at 30 June 2014 £'000
Assets				
Non-current				
Goodwill		**192,470**	192,003	158,786
Intangible assets		**34,299**	35,375	31,918
Share of net assets of joint ventures		**—**	1,856	—
Property, plant and equipment		**16,841**	15,880	14,778
Pensions and other employee benefits		**15,131**	15,131	14,731
Deferred tax asset		**9,499**	8,573	9,848
		268,240	268,818	230,061
Current				
Inventories		**9,341**	8,468	10,771
Trade and other receivables		**158,651**	142,616	160,977
Cash at bank and in hand		**63,606**	66,634	72,664
		231,598	217,718	244,412
Total assets		**499,838**	486,536	474,473
Equity				
Equity attributable to the shareholders of Mears Group PLC				
Called up share capital	9	**1,019**	1,011	1,011
Share premium account		**58,086**	56,714	56,656
Share-based payment reserve		**2,353**	1,653	1,350
Hedging reserve		**(640)**	(962)	(583)
Merger reserve		**46,214**	46,214	46,214
Retained earnings		**96,353**	92,179	81,182
Total equity shareholders' funds		**203,385**	196,809	185,830
Non-controlling interest		**(1,259)**	(2,347)	(774)
Total equity		**202,126**	194,462	185,056
Liabilities				
Non-current				
Long-term borrowing and overdrafts		**57,500**	57,500	55,000
Pension and other employee benefits		**8,372**	8,372	6,107
Deferred tax liabilities		**9,039**	9,418	9,265
Financing liabilities		**451**	788	420
Other liabilities		**26,392**	25,956	1,253
		101,754	102,034	72,045
Current				
Short-term borrowings and overdrafts		**10,291**	5,300	15,000
Trade and other payables		**173,608**	182,098	193,130
Financing liabilities		**533**	580	409
Current tax liabilities		**4,240**	2,062	2,464
Dividend payable		**7,286**	—	6,369
Current liabilities		**195,958**	190,040	217,372
Total liabilities		**297,712**	292,074	289,417
Total equity and liabilities		**499,838**	486,536	474,473

Half-year condensed consolidated cash flow statement

For the six months ended 30 June 2015

	Note	Six months ended 30 June 2015 £'000	Twelve months ended 30 June 2015 £'000	Six months ended 30 June 2014 £'000
Operating activities				
Result for the period before tax		**14,692**	**30,413**	13,957
Adjustments	10	**8,905**	**20,402**	8,694
Change in inventories and operating receivables		**(2,717)**	**21,371**	(9,925)
Change in operating payables		**(12,330)**	**(26,736)**	(3,189)
Cash inflow from continuing operating activities before taxes paid		**8,550**	**45,450**	9,537
Taxes paid		**(1,665)**	**(2,939)**	(1,011)
Net cash inflow from operating activities		**6,885**	**42,511**	8,526
Investing activities				
Additions to property, plant and equipment		**(1,809)**	**(3,214)**	(2,557)
Additions to other intangible assets		**(1,454)**	**(2,297)**	(642)
Proceeds from disposals of property, plant and equipment		**—**	**106**	—
Acquisition of subsidiary undertaking, net of cash		**(11,421)**	**(32,744)**	(897)
Interest received		**78**	**148**	6
Net cash outflow from investing activities		**(14,606)**	**(38,001)**	(4,090)
Financing activities				
Proceeds from share issue		**1,380**	**1,438**	578
Finance lease payments		**(244)**	**(305)**	—
Interest paid		**(1,434)**	**(3,240)**	(1,902)
Dividends paid		**—**	**(9,252)**	—
Net cash outflow from financing activities		**(298)**	**(11,359)**	(1,324)
Cash and cash equivalents at beginning of period		**3,834**	**2,664**	(448)
Net (decrease)/increase in cash and cash equivalents		**(8,019)**	**(6,849)**	3,112
Cash and cash equivalents at end of period		**(4,185)**	**(4,185)**	2,664

Cash and cash equivalents is comprised as follows:			
– cash at bank and in hand	**63,606**	**63,606**	72,664
– borrowings and overdrafts	**(67,791)**	**(67,791)**	(70,000)
Cash and cash equivalents	**(4,185)**	**(4,185)**	2,664

Cash conversion key performance indicator			
Cash inflow from operating activities	**8,550**	**45,450**	9,537
EBITDA	**23,447**	**49,611**	22,351
Conversion (%)	**36.4%**	**91.6%**	42.7%

Half-year condensed consolidated statement of changes in equity

For the six months ended 30 June 2015

	Attributable to equity shareholders of the Company							
	Share capital £'000	Share premium account £'000	Share-based payment reserve £'000	Merger reserve £'000	Hedging reserve £'000	Retained earnings £'000	Non-controlling interests £'000	Total equity £'000
At 1 January 2014	1,007	56,082	1,050	46,214	(848)	77,366	(570)	180,301
Net result for the period	—	—	—	—	—	10,185	(204)	9,981
Other comprehensive income	—	—	—	—	265	—	—	265
Total comprehensive income/(expense) for the period	—	—	—	—	265	10,185	(204)	10,246
Issue of shares	4	574	—	—	—	—	—	578
Share option charges	—	—	300	—	—	—	—	300
Dividends	—	—	—	—	—	(6,369)	—	(6,369)
At 30 June 2014	1,011	56,656	1,350	46,214	(583)	81,182	(774)	185,056
At 1 January 2015	1,011	56,714	1,653	46,214	(962)	92,179	(2,347)	194,462
Net result for the period	—	—	—	—	—	11,460	745	12,205
Other comprehensive income	—	—	—	—	322	—	—	322
Total comprehensive income for the period	—	—	—	—	322	11,460	745	12,527
Issue of shares	8	1,372	—	—	—	—	—	1,380
Share option charges	—	—	700	—	—	—	—	700
On acquisition	—	—	—	—	—	—	343	343
Dividends	—	—	—	—	—	(7,286)	—	(7,286)
At 30 June 2015	**1,019**	**58,086**	**2,353**	**46,214**	**(640)**	**96,353**	**(1,259)**	**202,126**

Notes to the half-year condensed consolidated statements

For the six months ended 30 June 2015

1. Corporate information

Mears Group PLC is a public limited company incorporated in England and Wales whose shares are publicly traded. The half-year condensed consolidated financial statements of the Company and its subsidiaries for the six months ended 30 June 2015 were authorised for issue in accordance with a resolution of the Directors on 16 August 2015.

2. Basis of preparation and accounting principles

(a) Basis of preparation

The half-year condensed consolidated financial statements for the six months ended 30 June 2015 have been prepared in accordance with the Disclosure and Transparency Rules (DTR) of the Financial Services Authority and with IAS 34 'Interim Financial Reporting'. The half-year condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the Group's annual financial statements as at 31 December 2014, which have been prepared in accordance with IFRS as adopted by the European Union.

This half-year condensed consolidated financial information does not comprise statutory accounts within the meaning of Section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 December 2014 were approved by the Board of Directors on 17 March 2015. These accounts, which contained an unqualified audit report under Section 495 of the Companies Act 2006 and which did not make any statements under Section 498 of the Companies Act 2006, have been delivered to the Registrar of Companies in accordance with Section 441 of the Companies Act 2006.

The half-year condensed consolidated financial statements for the six months ended 30 June 2015 have not been audited or reviewed by an auditor pursuant to the Auditing Practices Board guidance on Review of Interim Financial Information.

There have been no significant changes to estimates of amounts reported in prior financial years.

(b) Significant accounting policies

The accounting policies adopted in the preparation of the half-year condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2014 with the exception of the adoption of Improvements to IFRS 2011–2013 Cycle which was effective from 1 January 2015. These revisions to standards did not materially affect the financial statements.

3. Segment reporting

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

The Group operated two business segments during the period:

- Social Housing – services within this segment comprise a full repairs and maintenance service to Local Authorities and other Registered Social Housing Landlords in the UK; and
- Care – services within this segment comprise personal care services for people in their own homes.

All of the Group's activities are carried out within the UK and the Group's principal reporting to its chief operating decision maker is not segmented by geography. The principal measures utilised by the chief operating decision maker to review the performance of the operating segments are that of revenue growth and operating margins in both core divisions of Social Housing and Care. The operating result utilised within the key performance measures is stated before amortisation of acquisition intangibles, exceptional items and share-based payments. There is a small cyclical element to the Group's activities, which, combined with organic growth, results in the second half of the year traditionally showing increased margins over and above the first half of the year.

3. Segment reporting continued

	Six months ended 30 June 2015		Six months ended 30 June 2014	
	Revenue £'000	**Operating result £'000**	Revenue £'000	Operating result £'000
Social Housing	**366,545**	**18,203**	364,865	15,257
Care	**63,477**	**2,907**	63,206	4,912
	430,022	**21,110**	428,071	20,169
Long-term incentive plans	**—**	**(700)**	—	(950)
Operating result before intangible amortisation	**—**	**20,410**	—	19,219
Amortisation of acquisition intangibles	**—**	**(4,519)**	—	(4,750)
	—	**15,891**	—	14,469
Finance costs, net		**(1,199)**		(512)
Tax expense		**(2,487)**		(3,976)
		12,205		9,981

4. Net finance charge

	Six months ended 30 June 2015 £'000	Six months ended 30 June 2014 £'000
Interest charge on overdrafts and short-term loans	**(1,041)**	(1,061)
Interest charge on interest rate swap (effective hedges)	**(243)**	(387)
Interest charge on interest rate swap (ineffective hedges)	**(143)**	—
Interest charge on defined benefit obligation	**(225)**	(300)
Finance costs	**(1,652)**	(1,748)
Interest income resulting from short-term bank deposits	**78**	6
Interest income resulting from defined benefit obligation	**375**	1,230
Net finance charge	**(1,199)**	(512)

Notes to the half-year condensed consolidated statements continued

For the six months ended 30 June 2015

5. Tax expense

The tax charge for the six months ended 30 June 2015 has been based on the estimated tax rate for the full year.

Tax recognised in the Income Statement:

	Six months ended 30 June 2015 £'000	Six months ended 30 June 2014 £'000
United Kingdom corporation tax effective rate 17.6% (2014: 20.5%) and total current tax recognised in Income Statement	**3,391**	3,833
Adjustment in respect of previous periods	**—**	—
Total current tax recognised in Income Statement	**3,391**	3,833
Total deferred taxation recognised in Income Statement	**(904)**	143
Total tax expense recognised in Income Statement	**2,487**	3,976

6. Dividends

The interim dividend of 3.10p (2014: 2.85p) per share is not recognised as a liability at 30 June 2015 and will be payable on 3 November 2015 to shareholders on the register at the close of business on 16 October 2015. The dividend disclosed within the half-year Condensed Consolidated Statement of Changes in Equity represents the final dividend of 7.15p (2014: 6.30p) per share proposed in the 31 December 2014 financial statements and approved at the Group's Annual General Meeting on 3 June 2015 (not recognised as a liability at 31 December 2014).

7. Earnings per share

	Basic		Diluted	
	Six months ended 30 June 2015 p	Six months ended 30 June 2014 p	**Six months ended 30 June 2015 p**	Six months ended 30 June 2014 p
Earnings per share	**11.28**	9.89	**11.16**	9.75
Effect of amortisation of acquisition intangibles	**4.45**	4.71	**4.40**	4.63
Effect of full tax adjustment	**(0.96)**	(0.05)	**(0.94)**	(0.04)
Normalised earnings per share	**14.77**	14.55	**14.62**	14.34

7. Earnings per share continued

A normalised EPS is disclosed in order to show performance undistorted by amortisation of intangibles and exceptional costs. The Group defines normalised earnings as excluding the amortisation of acquisition intangibles and adjusted to reflect a full tax charge. The Directors believe that this normalised measure better allows the assessment of operational performance, the analysis of trends over time, the comparison of different businesses and the projection of future performance. The profit attributable to shareholders before and after adjustments for both basic and diluted EPS is:

	Six months ended 30 June 2015 £'000	Six months ended 30 June 2014 £'000
Profit attributable to shareholders:	**11,460**	9,981
– amortisation of acquisition intangibles	**4,519**	4,750
– full tax adjustment	**(971)**	(46)
Normalised earnings	**15,008**	14,685

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

	Six months ended 30 June 2015 Millions	Six months ended 30 June 2014 Millions
Weighted average number of shares in issue:	**101.62**	100.90
– dilutive effect of share options	**1.03**	1.50
Weighted average number of shares for calculating diluted earnings per share	**102.65**	102.40

8. Fair value measurement of financial instruments

IAS 34 requires that interim financial statements include certain of the disclosures about fair value of financial instruments set out in IFRS 13 and IFRS 7. These disclosures include the classification of fair values within a three-level hierarchy. The three Levels are defined based on the observability of significant inputs to the measurement, as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3: unobservable inputs for the asset or liability.

Notes to the half-year condensed consolidated statements continued

For the six months ended 30 June 2015

8. Fair value measurement of financial instruments continued

The following table shows the Levels within the hierarchy of financial assets and liabilities measured at fair value on a recurring basis at 30 June 2015, 31 December 2014 and 30 June 2014:

	As at 30 June 2015 £'000	As at 31 December 2014 £'000	As at 30 June 2014 £'000
Financial liabilities			
Fair value (Level 2)			
Interest rate swaps – effective	**(544)**	—	(829)
Interest rate swaps – ineffective	**(440)**	(1,368)	—
Fair value (Level 3)			
Contingent consideration in respect of acquisitions	**(21,055)**	(21,045)	(1,574)
	(22,039)	(22,413)	(2,403)

The fair values of interest rate swaps have been calculated by a third party expert discounting estimated future cash flows on the basis of market expectations of future interest rates (Level 2).

The fair values of deferred and contingent consideration have been calculated by the Directors by reference to expected future income and expenditure in respect of the acquired businesses.

There were no transfers between Level 1 and Level 2 during the six-month period to 30 June 2015 or the year to 31 December 2014.

The reconciliation of the carrying values of financial instruments classified within Level 3 is as follows:

	As at 30 June 2015 £'000	As at 31 December 2014 £'000	As at 30 June 2014 £'000
Balance, beginning of period	**21,045**	1,836	1,836
Increase due to new acquisitions in the period	**—**	20,000	—
Paid in respect of acquisitions	**—**	(387)	(282)
Released on reassessment	**—**	(424)	—
Unwinding of discounting	**10**	20	20
Balance, end of period	**21,055**	21,045	1,574

Contingent consideration represents an estimate of future consideration likely to be payable in respect of acquisitions. Contingent consideration is discounted for the likelihood of payment and for the time value of money. Contingent consideration becomes payable based upon the profitability of acquired businesses.

8. Fair value measurement of financial instruments continued

The carrying value of the following financial assets and liabilities is considered a reasonable approximation of fair value:

- trade and other receivables;
- cash and cash equivalents; and
- trade and other payables.

9. Share capital

	Six months ended 30 June 2015 £'000	Six months ended 30 June 2014 £'000
Allotted, called up and fully paid		
At 1 January 101,134,142 (2014: 100,661,649) ordinary shares of 1p each	**1,011**	1,007
Issue of 770,458 (2014: 440,641) ordinary shares of 1p each on exercise of share options	**8**	4
At 30 June 2015 101,904,600 (2014: 101,102,290) ordinary shares of 1p each	**1,019**	1,011

770,458 (2014: 440,641) ordinary 1p shares were issued in respect of share options exercised. The difference between the nominal value of £0.08m and the total consideration of £1.4m has been credited to the share premium account.

10. Notes to the half-year condensed consolidated cash flow statement

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

	Six months ended 30 June 2015 £'000	**Year ended 30 June 2015 £'000**	Six months ended 30 June 2014 £'000
Depreciation	**2,395**	**4,092**	2,667
Profit on disposal of property, plant and equipment	**—**	**3**	1
Intangible amortisation	**5,161**	**13,427**	5,214
Share-based payment charges	**700**	**1,070**	300
IAS 19 pension movement	**(700)**	**(1,195)**	(930)
Net finance charge	**1,349**	**3,005**	1,442
Total	**8,905**	**20,402**	8,694

Notes to the half-year condensed consolidated statements continued

For the six months ended 30 June 2015

11. Acquisitions

On 29 May 2015, the Group acquired 100% of the share capital of Care UK Homecare Limited and Care UK Community Care Agency Limited, the corporate entities comprising the Care at Home division of Care UK Limited (CAH). The total consideration was £10.2m in cash comprising a base payment of £9.0m together with further payments of £1.2m made in respect of excess working capital. An additional amount of £1.1m was paid on completion to settle short-term borrowings. CAH provides community-based care services to over 10,000 service users in England, Wales and Scotland, and it has contracts with over 90 Local Authorities and Clinical Commissioning Groups (CCGs), employing circa 6,000 staff. The acquisition of CAH significantly increases the scale of Mears within the domiciliary care market, making Mears the second biggest provider in the UK.

The provisional effect of the acquisition on the Group's assets was as follows:

	Provisional book and fair value		
	CAH £'000	Other £'000	Total £'000
Assets			
Non-current			
Property, plant and equipment	893	38	931
Deferred tax asset	971	28	999
Current			
Inventories	37	—	37
Debtors	12,660	1,493	14,153
Cash	—	383	383
Total assets	14,561	1,942	16,503
Liabilities			
Current			
Creditors	(5,513)	(1,134)	(6,647)
Short-term borrowings	(1,262)	—	(1,262)
Total liabilities	(6,775)	(1,134)	(7,909)
Net assets acquired	7,786	808	8,594
Intangibles capitalised	2,431	200	2,631
Deferred tax liability recognised in respect of intangibles capitalised	(486)	(40)	(526)
Net assets acquired	9,731	968	10,699
Goodwill capitalised	467	—	467
	10,198	968	11,166
Satisfied by:			
– cash	10,198	344	10,542
– fair value of previously held equity interest	—	281	281
– fair value of non-controlling interest	—	343	343
	10,198	968	11,166

11. Acquisitions continued

The fair value of assets acquired is considered to be provisional due to the scale and complexity of the transaction. The full exercise to determine the intangible assets acquired is still to be completed; thus, these numbers are also provisional.

The Directors consider the value assigned to goodwill represents the benefits to the Group of improvements in the delivery of Social Housing and Housing Management.

In the period, the acquisition of CAH delivered revenue and an operating loss before the amortisation of acquisition intangibles of £5.0m and £0.49m, respectively. For the period to 30 June 2015, had the acquisitions taken place on 1 January 2015, the combined Group full-year revenue for the period is estimated at £455.8m. Given the allocation of area and central overheads within the acquired CAH business, the impact upon Group profits cannot be accurately estimated.

12. Half-year condensed consolidated financial statements

Further copies of the Interim Report are available from the registered office of Mears Group PLC at 1390 Montpellier Court, Gloucester Business Park, Brockworth, Gloucester GL3 4AH or www.mearsgroup.co.uk.

13. Principal risks and uncertainties

The nature of the principal risks and uncertainties faced by the Group has not changed significantly from those set out on pages 22 to 25 of the 2014 Annual Report and Accounts and is not expected to change over the next six months. Those risks and uncertainties are separated into three principal risks and five additional risks. The three principal risks are: reputation, people, and health and safety. The five additional risks are: markets; integrity, ethics, anti-bribery and corruption; taxation, legal and regulatory; business continuity; and liquidity.

14. Forward-looking statements

This report contains certain forward-looking statements with respect to the financial condition, results of operations and businesses of Mears Group PLC. These statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements.

The Directors confirm, to the best of their knowledge, that this condensed set of financial statements has been prepared in accordance with IAS 34 as adopted by the European Union and that the Interim Report includes a fair review of the information required by Rules 4.2.4, 4.2.7 and 4.2.8 of the Disclosure and Transparency Rules of the UK Financial Services Authority.

The names and functions of the Directors of Mears Group PLC are as listed in the Group's Annual Report for 2014.

By order of the Board

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17 August 2015

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

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

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