# Mears Group PLC

Interim results for the period ended 30 June 2019

# Agenda

→ Strategic update

→ Finance review

→ Operational review

→ Outlook

# Strategic update

## David Miles, Chief Executive Officer

# Continued strategic progress and solid performance

- **Satisfactory financial performance**
  - Revenue £480.8m, up 10% (2018: £435.3m)
  - Adjusted profit before tax £17.1m, down 10% but in line with guidance (2018: £19.0m)
  - Normalised diluted EPS 12.27p, down 18% (2018: 15.04p)
  - Interim dividend per share 3.65p, up 3% (2018: 3.55p)
  - Average daily net debt £110.7m, marginally ahead of target (2018 H1: £112.1m, 2018 FY: £113.2m)
  - 2019 figures reflect the impact of IFRS 16
- **Order book increasing to £3.0bn (2018: £2.1bn)**
  - AASC award in excess of £1bn
  - Successful period of new contract bidding, augmented by acquisition of MPS
- **Excellent progress made on both integration of MPS and mobilisation of AASC**
- **Mears is well placed to secure further placemaking opportunities**

Our financial and market position is robust as we seek to build on existing strengths and take advantage of new opportunities.

# Solid progress in first half

→ **Acquisition of MPS**
  - → Solid progress in line with expectations
  - → Significant cost synergies identified and captured
  - → Migration to Mears IT substantially complete
  - → Customer-service, people, and operations ahead of plan
  - → On track to deliver turnaround in line with previous guidance; 3% operating margin for 2019, increasing to 5% in 2020
  - → Robust due diligence; deal mechanism de-risked transaction

Before completion of the MPS transaction, the London Borough of Hammersmith & Fulham issued notice of termination. Mears was subsequently awarded a contract on an emergency basis which went live in April 2019. Mears is also supporting the client's in-house maintenance team. This is a key client relationship with significant future work opportunities.

→ **Asylum Accommodation and Support Services Contract (AASC)**
  - → First half has seen a period of intensive mobilisation
  - → Mears approach to service delivery, procuring managed property from a wide pool, is resulting in a shift in the stakeholder base and their attitude towards the contract
  - → All milestones to date have been achieved
  - → IT systems in place and substantial testing carried out, full contract start on 1 September
  - → The TUPE transfer is progressing and significant investment has been made in induction, training & development

Completed inspections of 5,500 homes ahead of target and reached an advanced stage of securing existing compliant properties on Mears' T&Cs.
We are making good progress acquiring properties to plug the shortfall. Mears is resolving challenges at mobilisation to secure a long term benefit.

# Solid progress in first half

→ **Development**
  → Working capital maintained at Q4 2018 level
  → Delivering against commitment to exit new build activities which require the Group to provide working capital
  → Accelerated speed of unwind; agreed withdrawal from two projects which had end dates stretching to late 2021
  → Endeavour to complete much of the funded development by end 2020
  → Development of solutions to participate in Placemaking opportunities with alternative route for funding

Whilst the working capital tied up in Development is higher than originally planned, the numbers are of a sufficiently low level to allow the Company to continue to withdraw from this activity through a controlled unwinding of revenue and working capital as sites are completed and sold.

→ **Working capital and net debt**
  → Average net debt marginally better than expectations
  → Solid working capital performance across all business units
  → Reduction in property acquisition facility. Further reduction anticipated in second half
  → Average daily net debt target for 2019 at £105m and the key target remains 1x EBITDA by end of 2020 (based on pre IFRS 16 measures)

Mears' Placemaking offering remains unique in the market and we remain well placed for major opportunities in 2019 and beyond.

The changes communicated in March 2019 are progressing well and the debt position is improving in line with guidance.

# Finance review

## Andrew Smith, Finance Director

# Income Statement

| | H1 2019 as reported | Impact of IFRS 16 | H1 2019 before the impact of IFRS 16 | H1 2018 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| **Sales revenue** | **480.8** | — | 480.8 | 435.3 |
| Cost of sales | **(363.7)** | (2.4) | (366.1) | (333.9) |
| **Gross profit** | **117.0** | (2.4) | 114.6 | 101.3 |
| Other administration expenses | **(93.9)** | (1.4) | (95.3) | (80.9) |
| **Operating result before amortisation of acquisition intangibles and exceptional costs** | **23.1** | (3.8) | 19.3 | 20.5 |
| Exceptional costs | **—** | — | — | (4.0) |
| Amortisation of acquisition intangibles | **(4.6)** | — | (4.6) | (2.2) |
| **Total administration expenses** | **(98.5)** | (1.4) | (100.0) | (87.0) |
| **Operating profit** | **18.5** | (3.8) | 14.7 | 14.3 |
| Net finance charge | **(6.1)** | 4.6 | (1.4) | (1.5) |
| **Profit for the period before tax, amortisation of acquisition intangibles and exceptional costs** | **17.1** | 0.8 | 17.8 | 19.0 |
| **Profit for the period before tax** | **12.5** | 0.8 | 13.3 | 12.9 |
| Tax expense | **(2.0)** | (0.1) | (2.1) | (2,0) |
| **Profit for the period** | **10.5** | 0.6 | 11.1 | 10.8 |
| | | | | |
| **Earnings per share** | | | | |
| Basic | **9.16p** | | | 10.49p |
| Diluted | **9.12p** | | | 10.44p |
| Normalised diluted | **12.27p** | | | 15.04p |
| | | | | |
| **Interim dividend** | **3.65p** | | | 3.55p |

- → H1 2019 adopts IFRS 16. Prior periods not restated
- → In-line with management expectations and guidance
- → H1 EPS is sensitive to the impact of the MPS acquisition

# Segmental reporting*

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Revenue** | **Operating profit** | **Margin** | Revenue | Operating profit | Margin |
| | **£m** | **£m** | **%** | £m | £m | % |
| Maintenance | **323.3** | **14.6** | **4.5%** | 292.9 | 14.5 | 4.9% |
| Management | **78.7** | **3.9** | **5.0%** | 67.9 | 3.5 | 5.2% |
| Development | **27.7** | **(0.9)** | **(3.2%)** | 14.1 | 1.0 | 7.1% |
| Housing | **429.7** | **17.6** | **4.1%** | 374.9 | 19.0 | 5.1% |
| Care | **51.1** | **1.7** | **3.4%** | 60.3 | 1.9 | 3.1% |
| **Group** | **480.8** | **19.4** | **4.0%** | **435.3** | **20.8** | **4.8%** |

* figures reported before the impact of IFRS 16 and share based payments

→ Maintenance: MPS adds £55m revenues and some margin dilution. Underlying margins on-track

→ Management: Asylum brings growth but some margin dilution as expected

→ Development: revenues and margins in line with guidance, reflecting actions taken to reduce exposure in this area

→ Care: reflects focus on quality and operating margin

# Consolidated Balance Sheet

| | **Reported June 2019** | MPS acquisition | Adjustments for IFRS 16 | **Adjusted June 2019** | June 2018 |
|---|---|---|---|---|---|
| | **£m** | £m | £m | **£m** | £m |
| Goodwill and intangible assets | **225.6** | (18.8) | 0.0 | **206.8** | 208.7 |
| Property, plant and equipment | **25.4** | (0.3) | 0.0 | **25.1** | 24.4 |
| Right of use asset | **167.5** | 0.0 | (167.5) | **0.0** | 0.0 |
| Inventories | **34.8** | (0.3) | 0.0 | **34.6** | 26.8 |
| Trade receivables | **174.7** | (42.3) | 0.0 | **132.4** | 132.3 |
| Property assets held for resale | **12.6** | 0.0 | 0.0 | **12.6** | 30.9 |
| Trade payables | **(195.2)** | 27.5 | 0.0 | **(167.7)** | (176.5) |
| Operating net debt | **(48.6)** | 7.3 | 0.0 | **(41.3)** | (44.5) |
| Property acquisition facility | **(15.0)** | 0.0 | 0.0 | **(15.0)** | (30.0) |
| Lease obligations | **(175.9)** | 0.0 | 174.8 | **(1.1)** | 0.0 |
| Contingent consideration | **(1.3)** | 1.3 | 0.0 | **0.0** | 0.0 |
| Dividend | **(9.8)** | 0.0 | 0.0 | **(9.8)** | (8.9) |
| Pension | **11.9** | 0.0 | 0.0 | **11.9** | 22.3 |
| Taxation | **(2.3)** | 3.3 | (1.3) | **(0.3)** | 0.4 |
| Net assets | **204.3** | (22.3) | 6.1 | **188.2** | 186.1 |

- → Adjusted 2019 Balance Sheet to aid comparability with 2018
- → Solid working capital performance
- → Reduction in pension surplus but risks well managed

# Consolidated Cash flow

| | H1 2019 as reported | H1 2019 before the impact of IFRS 16 | H1 2018 |
|---|---|---|---|
| | £m | £m | £m |
| EBITDA | **42.7** | **23.4** | 20.6 |
| Other adjustments | **0.5** | **0.5** | 0.5 |
| Working capital inflow (outflow) | **2.3** | **2.3** | (17.8) |
| Cash inflow from operating activities before taxes | **45.5** | **26.2** | 3.4 |
| Taxes received | **0.1** | **0.1** | 0.8 |
| Cash outflow from discontinued operations | **(1.8)** | **(1.8)** | (1.0) |
| Capital expenditure | **(5.2)** | **(5.2)** | (6.4) |
| Purchase of subsidiary undertakings | **0.0** | **0.0** | (11.2) |
| Discharge of lease liabilities | **(14.8)** | **(0.2)** | (0.4) |
| Issue of shares | **0.0** | **0.0** | 0.1 |
| Dividends | **0.0** | **0.0** | (0.6) |
| Net interest paid | **(6.2)** | **(1.6)** | (1.7) |
| Other financing and investing activities | **(0.3)** | **(0.3)** | (1.9) |
| Change in cash | **17.3** | **17.3** | (18.7) |
| Opening net debt | **(65.9)** | **(65.9)** | (25.8) |
| Closing net debt | **(48.6)** | **(48.6)** | (44.5) |

→ Strong working capital performance in first half

→ IFRS 16 alters shape of cash flow statement

# Working capital

| | 2019 - 6 month average | | | 2018 - 12 month average | | |
|---|---|---|---|---|---|---|
| | **Receivable** | **Payable** | **Net** | Receivable | Payable | Net |
| | £m | £m | **£m** | £m | £m | £m |
| Maintenance | 125.1 | (110.6) | **14.5** | 123.2 | (104.2) | 19.0 |
| Management | 25.6 | (21.9) | **3.7** | 21.0 | (19.3) | 1.7 |
| Development | 31.8 | (9.1) | **22.7** | 21.2 | (5.6) | 15.6 |
| Care | 17.2 | (4.5) | **12.7** | 19.0 | (5.4) | 13.6 |
| Total pre MPS | 199.7 | (146.1) | **53.6** | 184.4 | (134.5) | 49.9 |
| MPS | 40.9 | (26.8) | **14.1** | | | |
| Total | 240.6 | (172.9) | **67.7** | 184.4 | (134.5) | 49.9 |

→ Working capital movements in respect of core high volume and low value activities are well controlled and tracking underlying activity

→ Working capital absorbed in Development is consistent with December 2018 run-rate

→ Focus upon MPS working capital balances in H2 and the continued unwinding of Development

# Net debt

| | H1 2019<br>£m | H1 2018<br>£m |
|---|---|---|
| Average daily net debt (operating)* | **(110.7)** | (112.1) |

* Excludes property acquisition facility.

| | H1 2019<br>£m | H1 2018<br>£m |
|---|---|---|
| Spot net debt (operating) at 30 June | **(48.6)** | (44.5) |
| Spot net debt (property acquisition) at 30 June | **(15.0)** | (30.0) |
| Total net debt at 30 June | **(63.6)** | (74.5) |

→ On track to deliver £105.0m average daily net debt for FY 2019

→ Further reduction in property acquisition facility anticipated during H2

→ Lease obligations not included within definition of net debt

# IFRS 16, 'Leases'

→ Effective from 1 January 2019 but no restatement of comparatives

→ Aligns treatment of operating leases and finance leases; Balance Sheet reflects a value for the right to use the asset together with an associated liability

→ The Group is not required to restate comparative information but to instead adjust opening equity

→ The key impacts to the Balance Sheet and Income Statement in the first half are detailed below:

| | Right of use asset £m | Lease obligation £m | Income Statement £m |
|---|---|---|---|
| Balance brought forward on transition | 163.1 | (169.7) | - |
| Additions | 19.8 | (19.8) | |
| Depreciation | (15.4) | - | (15.4) |
| Interest | - | (4.6) | (4.6) |
| Lease payments | - | 19.3 | 19.3 |
| **Carrying value at 30 June 2019** | **167.5** | **(174.8)** | **(0.8)** |

→ The impact on PBT is neutral over the lease term but the profit phasing is not straight line

→ The Group will continue to review its application of this standard over the second half year. Any revisions to the transitional adjustments would not be expected to be material to the Income Statement

# Operational review

## David Miles, Chief Executive Officer

### Updates on key investor issues:

→ Bidding activity
→ Development
→ Asylum Accommodation and Support Services Contract (AASC)
→ MPS
→ Care
→ Forward order book

# Excellent period of new contract bidding; well placed for further success

**The development of Mears Placemaking capability has widened its current and potential client base and as a result changes our view on what bid success looks like:**

- → Asylum Accommodation Services Contract — secured ✓
- → MOD ‘Outside the wire’ accommodation — secured ✓
- → More Homes Bromley / Waltham Forest — secured ✓
- → Milton Keynes Integrated Asset Management — secured ✓
- → Rotherham Metropolitan Borough Council — shortlisted ✓
- → MOD ‘Inside the wire’ accommodation — shortlisted ✓
- → Crawley Homes — shortlisted ✓
- → North Lanarkshire Council — bidding ✓

**Traditional Maintenance Contract wins**

Home Group
Hammersmith & Fulham
Longhurst Group

**Mobilisations**

Asylum Accommodation Services Contract (AASC)
Hammersmith & Fulham
Longhurst Group

**Future Opportunities**

North Lanarkshire
Ministry of Defence

Well placed to strengthen position as market leader in Maintenance

# Good progress on exiting funded development

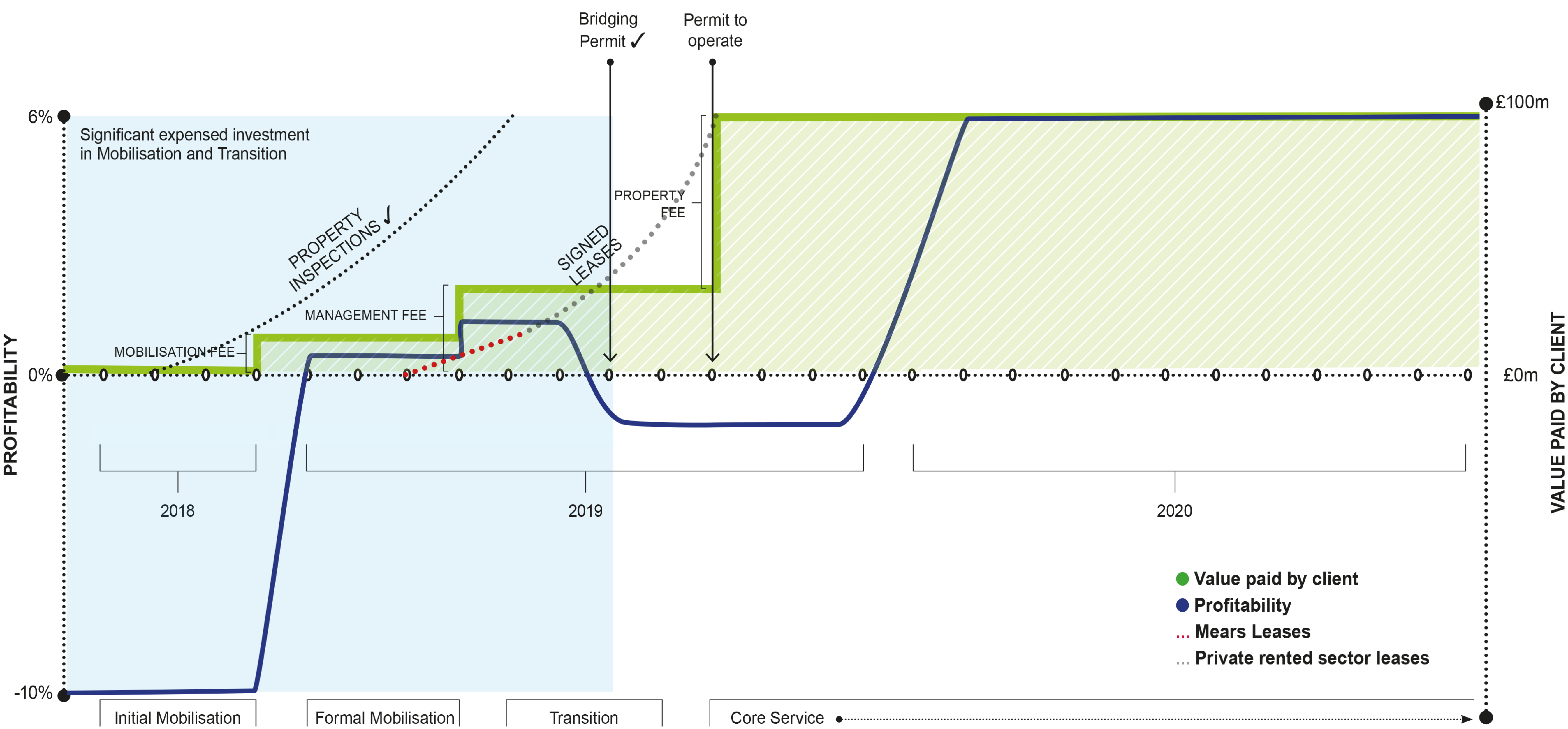
→ Working capital maintained at Q4 2018 level

→ Accelerated speed of unwind; agreed withdrawal from two projects which had end dates stretching to late 2021. Expectation is that the withdrawal will have been substantially completed by the end of 2020

→ Whilst working capital absorbed in this area has been higher than planned, the developments are considered low risk; low number of units, few sites, all partnerships with Registered Providers

→ Continued withdrawal from this activity through a controlled unwinding of revenue and working capital as sites are completed and sold

# Asylum Accommodation and Support Services Contract (AASC)




→ Mears is in the process of growing its housing portfolio of suitable properties to support the AASC contract

→ Full go live date is 1 September 2019

# MPS – excellent progress

## Clients

- ✓ Commitment from all clients to continue relationship
- ✓ Positive response to acquisition and MPS brand
- ✓ Hammersmith and Fulham de-mobilised well and relationship retained

## People

- ✓ Strong senior team becoming embedded within wider Mears structure
- ✓ Response to staff survey was positive despite ongoing reorganisation

## Transformation

- ✓ Progress has been rapid in terms of integration of the business and delivery of synergies
- ✓ MCM in over 80% of branches, roll out to be completed ahead of schedule by the end of September

## Customers

- ✓ Service delivery is good
- ✗ Some local issues, often due to outdated IT systems
- ✗ Further work to be done to bring satisfaction scores up to >90% in line with Mears business

## Commercial

- ✓ Performance in line with expectations
- ✓ Benefitting from a thorough and robust due diligence and negotiation process
- ✗ Driving financial improvements falls into phase 2 of integration plan

# Accelerating the repositioning of Care

- The market has continued to progress as Mears anticipated
- The review of the Care business in 2016 has subsequently been justified by market developments
- No significant change from Central Government; sector continues to wait for the promised Green Paper
- As a result, our strategy remains clear

| | |
|---|---|
| Continue phased withdrawal from standalone Domiciliary Care contracts | ✓ |
| Commitment to Housing with Care | ✓ |
| Care capability a key contributor to Placemaking and new opportunities | ✓ |

- **This represents a continuation of a controlled evolution in Mears' approach to its Care business as communicated in previous results presentations**

  - August 2016 – Care Transformation Programme
  - August 2017 – No future bidding of standalone Care contracts
  - August 2018 – Continue to use the operational strength of the Care business to support Housing with Care opportunities and strengthen Mears' competitive advantage

# Strong and visible forward order book

- → Strong period of order book growth, increasing to £3.0bn (June 2018: £2.1bn)
- → Order book target £2.7bn at 2019 year end given timing of new bids
- → Successful period of new contract bidding; over £350m of new business awards
- → Revenues for FY2019 in line with guidance
- → High quality order book with visible operating margins

**Forward order book**

| January 2019 | Reduction in order book in period | Orders secured year to date | June 2019 |
|---|---|---|---|
| £3.2bn | -£481m | +£350m | £3.0bn |
| | | LBHF<br>Longhurst<br>Home Group<br>Angus Council<br>Cross Keys Homes extension | |

- → In addition, solid pipeline of new bidding opportunities, including work for MoD and North Lanarkshire
- → Retention plan in place for the significant number of rebids in 2019/2020. Represents major opportunity to further bolster the forward order book

# Outlook

## David Miles, Chief Executive Officer

# Outlook

The Board is clear about its priorities for the coming twelve months, delivering the basics well:

→ Sticking to its knitting (focus on Housing)

→ Accelerating the evolution of Care with emphasis on Housing with Care

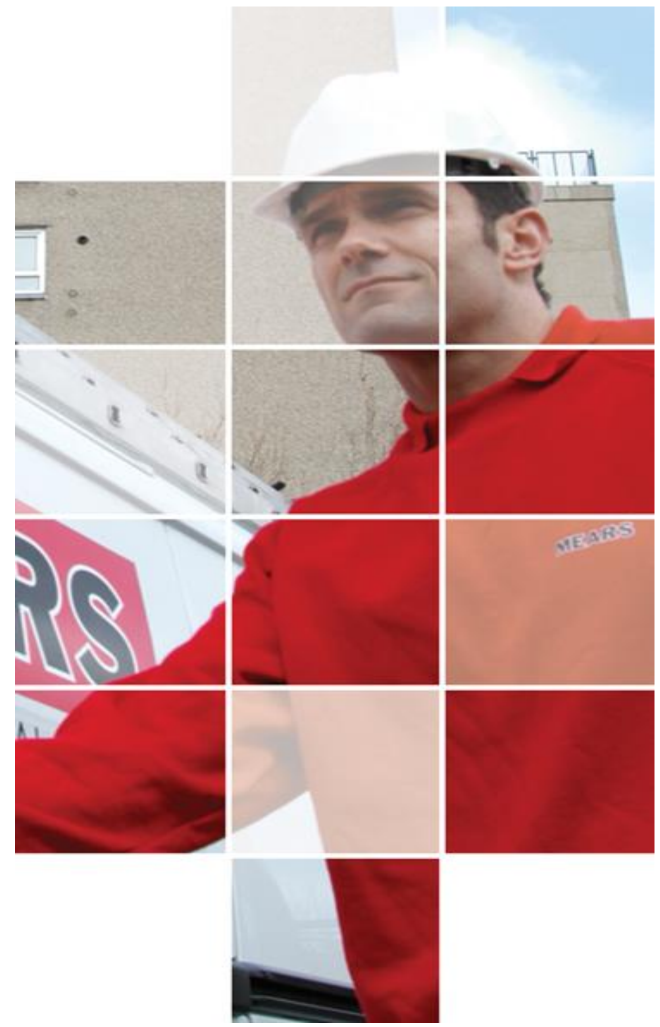
→ Controlled targeted reduction in net debt driven by strong working capital management and withdrawal from development

→ Complete MPS integration and achieve 5% run-rate operating margin by the end of 2019

→ Successful implementation and profitable operation of the AASC contracts

→ Maintain high levels of customer service which underpins the financial outputs

→ The Board remains confident of delivering its expectations for the full year, in line with previous guidance



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