

Perfectly positioned

Annual report and accounts 2019
Smart Metering Systems plc



Providing the complete energy service

A trusted partner providing an end-to-end service, we connect, own, operate and maintain metering systems and databases on behalf of energy suppliers, and we deliver metering, energy management and utility connection services directly for large energy consumers and multi-site organisations.

We have been at the heart of the UK energy market for over two decades and are playing a critical role in transforming and decarbonising the UK energy system.



Strategic report

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Read more about SMS on our
new investor website:

sms-plc.com/corporate

Continued growth despite a rapidly changing UK energy market.

Financial summary

Pre-exceptional EBITDA¹

£58.9m 14% ▲

(2018: £51.6m)

Statutory EBITDA

£50.4m 42% ▲

(2018: £35.5m)

Index-linked annualised recurring revenue (ILARR)¹

£90.1m 20% ▲

(2018: £75.3m)

Underlying profit before taxation¹

£15.6m 38% ▼

(2018: £25.1m)

Statutory profit before taxation

£5.5m 2% ▲

(2018: £5.4m)

Revenue

£114.3m 16% ▲

(2018: £98.5m)

Underlying basic earnings per share¹

11.30p 39% ▼

(2018: 18.46p)

Statutory basic earnings per share

3.56p 10% ▼

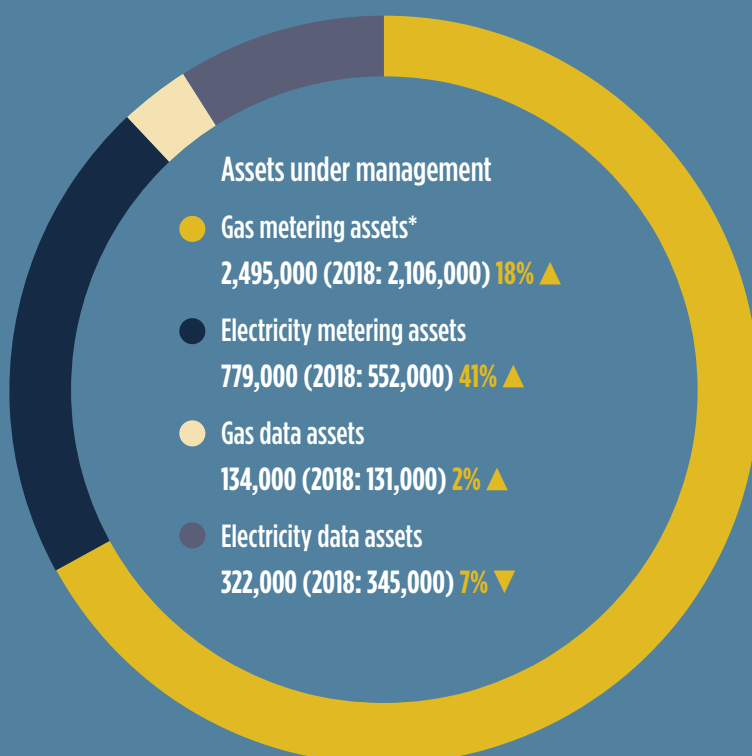
(2018: 3.97p)

Dividend per share (full year)

6.88p 15% ▲

(2018: 5.98p)

Operational performance



Smart meters

1,214,000 44% ▲

(2018: 846,000)

Capital expenditure on revenue-generating assets

£95.2m 26% ▼

(2018: £128.2m)

Total staff numbers

1,274 32% ▲

(2018: 964)

¹ Refer to the Financial Review for definitions and details on the Group's alternative performance measures, which includes index-linked annualised recurring revenue, pre-exceptional EBITDA, underlying profit before taxation and underlying basic earnings per share.

* Includes third-party management assets.

Delivering the future of smart energy

SMS is a major energy services and smart metering company with technology and sustainability at the core of its ethos and business model.

Our vision

To be at the heart of the low-carbon, smart energy revolution that is pivotal to realising a greener, more sustainable world.

Our mission

To deliver the future of smart energy.

We do this by providing smart meter and grid infrastructure programmes, as well as data-driven services, which enable us to provide greater control over the generation, use and storage of energy.

We use finance, technology, engineering skills and knowledge to provide these solutions for our customers, delivering value to them, reducing carbon emissions, and generating long-term sustainable and recurring revenue streams.

See our business model **14** **15**

Why invest in SMS?

1

At the heart of the zero-carbon and smart energy revolution

2

Strong, sustainable dividends with further potential to enhance value

3

Robust, integrated delivery platform with well-established industrial partnerships

4

Highly experienced management team committed to deliver shareholder value

See our investment case **04** **05**

Our business model is based on owning, installing, operating and maintaining gas and electric metering systems and databases on behalf of energy suppliers, as well as providing downstream energy and environmental management services for large energy consumers and multi-site organisations. This fully integrated, end-to-end energy service distinguishes us within the market.

What we do

We provide an end-to-end service in all aspects of metering, utility connections and energy management.

Our fully integrated energy service covers:

See our Operational Review **23–28**



Asset management

Smart metering and data services

Installation and management of meter and energy infrastructure assets and related data services



Asset installation

Smart utility services

Design, installation and management of utility connections and energy infrastructure



Energy management

Smart energy services

Ongoing delivery of energy management and carbon reduction solutions, including the operation of carbon reduction assets

Whilst proud to be market leaders in each of these areas individually, it is our comprehensive service offering that makes us truly unique in our industry. There are no other UK organisations in a position to offer all these services in house simultaneously, meaning our customers do not have to worry about finding additional partners to deliver other parts of their energy related projects.

Our partners

Our customers are at the heart of everything we do.

We aim to deliver long-lasting customer satisfaction. Our flexible and bespoke metering, data and utility solutions are designed to fit their every need and provide a complete energy service from beginning to end.



Developers

- ▶ Major UK housebuilders
- ▶ UK-wide private and public property development organisations



Utilities

- ▶ Major UK energy suppliers
- ▶ Independent energy suppliers
- ▶ Rapidly growing new market participants



Enterprises

- ▶ Retail chains
- ▶ Large supermarkets
- ▶ High street banks
- ▶ Major rail and telecoms companies
- ▶ Public sector organisations
- ▶ I&C businesses

Securing long-term, sustainable value for all stakeholders

SMS is perfectly positioned to maximise the opportunities available from Carbon Reduction (CaRe) assets whilst enhancing shareholder value.



1

At the heart of the zero-carbon and smart energy revolution

In 2019, the UK became the first major economy to pass the net-zero emissions law. Our vision is to be at the heart of the smart energy, low-carbon revolution, and we have built our services around transforming and decarbonising the UK energy system.

For over two decades, SMS has focused on providing CaRe solutions to the UK's largest emissions sectors: power, transport, residential and business, which together emit more than all other sectors combined.

We are also dedicated to reducing our own carbon footprint through effective management of our business estate and fleet.

The next few years will see intense evolution across the energy production and consumption landscape and we are primed to lead the transformation to a more sustainable world.

Refer to our Sustainability Report on pages 34 to 37 for further details.



2

Strong, sustainable dividends with further potential to enhance value

Our existing portfolio of mature assets underpins the Group dividend policy, with additional levers to rebase dividends in the future.

- **Resilient balance sheet:** The infrastructure nature of its underlying cash flows provides SMS with several options to fund its growth: i) residual long-term cash flows from its existing portfolio; (ii) a revolving credit facility; iii) further capital optimisation options; and iv) access to low-cost infrastructure funding. The Group intends to maintain future leverage at prudent levels.
- **Attractive growth opportunities:** SMS has significant growth opportunities to expand ILARR, with an existing order book of c.2 million meter points alone. SMS has also developed a pipeline of opportunities in CaRe assets, with recent independent funding support from an infrastructure fund.
- **Potential to rebase:** By the end of 2019 SMS had generated ILARR of £59.2m through its I&C and domestic smart meter portfolios. These highly sustainable, annuity-style cash flows enable SMS to provide shareholders with long-term sustainable dividends, growing at least in line with RPI, with good cash cover and scrip alternatives. A combination of existing long-term cash flows and growth opportunities to generate additional long-term revenue streams, coupled with attractive funding options, provides several levers to rebase dividends in the future.

3

Robust, integrated delivery platform with well-established industrial partnerships

Since its inception, SMS has invested significant resources in creating an end-to-end integrated delivery platform, underpinned by extensive industrial expertise and:

- ▶ **Well-established infrastructure:** SMS has a well-established utility infrastructure through its three core businesses of asset management, asset installation and energy management. Our internally trained engineer workforce provides the Group with significant competitive advantage, enabling the provision of a wide range of services and the development of our asset base.
- ▶ **Robust technology platform:** SMS's delivery platform is supported by its own central, cloud-based IT and data platform, which is subject to ongoing development to meet the needs of our customers and the industry. Through the acquisition of Solo Energy, the Group now has access to a software platform, FlexiGrid, that will control and integrate the operation of renewable energy assets.
- ▶ **Collaborative industrial partnerships:** We are proud of the relationships we have formed with our partners over the past 20 years. This includes energy suppliers, I&C enterprises, local authorities, housing associations, Distribution Network Operators and industrial groups across a variety of sectors including telecoms, utilities, hotels, infrastructure, water metering and technology. These partnerships enable us to identify attractive opportunities well in advance.

This places SMS at the forefront of energy efficiency and carbon reduction strategies and we are now well positioned to extend our offering to CaRe assets.

4

Highly experienced management team committed to deliver shareholder value

The SMS Board and Executive team have an optimal blend of experiences, including decades of association with the utilities and smart meter industries, experience in managing a nationwide engineering workforce and technological platform, and a solid background in infrastructure finance. This multitude of capabilities enables the Group to successfully navigate through the fast-changing energy landscape whilst continuing to deliver value for all stakeholders.

c.2 million

smart meter order book

c.£40m

ILARR to be added



Perfectly positioned to deliver the future of smart energy

The Group delivered a solid trading performance in a challenging market.

Introduction

I am pleased to report that we ended the year in line with our expectations and delivered continued growth in our ILARR, despite various industry-wide challenges. The continued volatility in the UK smart meter rollout has seen industry installation run rates lag behind previously anticipated volumes and technical issues, beyond our control, have meant delays to certain customers getting "SMETS2 ready". As a result, we have had to navigate the knock-on effect of this on our operational activity and financial results.

Despite these challenges, and the resulting impact on our short-term profitability, it is important that we keep sight of the long-term opportunities our business can address. The smart meter rollout remains core to a lower carbon future for the UK. Further, the strategic acquisition of Solo Energy has strengthened our energy services platform to accelerate the delivery of extended energy services to our customers.

We previously announced that we were exploring options to monetise the value of a minority of the Group's meter assets. On 12 March 2020, the Group conditionally agreed to dispose of a minority of the Group's meter assets for gross consideration of £291m. This represents £18.4m ILARR and SMS will continue to manage the disposed assets for an RPI-linked management fee of c.£0.8m.

This transaction generates considerable cash returns and demonstrates the substantial value of our smart meter portfolio. The value that this transaction delivers enables the acceleration of shareholder returns, with the proposal of a significant change to our dividend policy, detailed further below.

We remain focused on securing long-term sustainable revenue streams, supported by an efficient capital structure, and are committed to seeking additional opportunities that enable the fulfilment of our mission: to deliver the future of smart energy.

Our results

Investment in our portfolio of revenue-generating assets has remained strong, reflected in the 20% increase in our ILARR to £90.1m and an overall increase in our assets under management to 3.7 million from 3.1 million at the end of 2018.

Our business delivered a resilient performance this year, despite the challenges we faced with delays in the smart meter rollout.

Whilst our statutory profitability after tax was lower than last year, our pre-exceptional EBITDA of £58.9m continued to grow, reflecting the strength of our index-linked, recurring revenue base together with the significant efforts of the management team to manage our cost base in order to mitigate the impact of the rollout delays on our near-term profitability.

Navigating the smart meter rollout and creating opportunities for the future

The UK smart meter rollout continues to represent a core opportunity for us over the next few years. With 16.5 million smart and advanced meters operating as at 31 December 2019, there are still c.36.5 million meters to be exchanged.

Our contracted c.2 million pipeline opportunity from existing contracts with independent energy suppliers should add a further c.£40m of ILARR. With the range of technical issues during 2019 now predominantly resolved, as further detailed in the Operational Review on pages 25 to 28, our focus for 2020 is to work closely with our customers and help them deliver their smart meter installation plans efficiently and effectively.

The energy market provides a wealth of opportunities for future growth, especially as the UK continues its decarbonisation journey with a legally binding net-zero carbon emission target by 2050. A new market for the management and operation of Carbon Reduction (CaRe) assets, including EV charging points and battery storage, continues to evolve and developments in this space are accelerating. We are already well positioned to respond with the strategic acquisition of Solo Energy and its FlexiGrid platform, which operates the integration of energy storage systems, renewable generation and vehicle charging into the UK's energy systems and builds out our energy management business.

Delivering our strategy

During 2019 we were focused on continued growth of our ILARR, including preparations for the establishment of an asset base in CaRe assets, and overall operational efficiency through careful management of our installation capacity and engineering productivity.

The smart meter rollout will remain the core focus in the immediate future and with an increasing installed base of smart meters we continue to progress the origination of new CaRe assets. With the likely extended rollout period for smart meters, we will ensure our resources and cost base are aligned with a strong focus on operational efficiency.

Our strategic priority of capital efficiency has been the subject of a comprehensive review by the Board, to ensure we are optimising our capital structure in the face of changing markets and opportunities. The recently announced disposal of a minority of our I&C portfolio assists in the delivery of this. We have also entered into a partnership with the Columbia Threadneedle Sustainable Infrastructure Fund (ESIF) to finance our pipeline of CaRe assets. Further details are provided in the Chief Executive Officer's Statement.

Dividend

Over the last few years, we have aimed to provide a progressive, through-cycle dividend that shares the rewards of our profitability and growth with shareholders and provides a sustainable return. In this context, the Board is recommending a second interim dividend of 4.58p per ordinary share and no final dividend for the year ended 31 December 2019 (2018: no second interim dividend, final dividend of 3.98p). In addition to the first interim dividend of 2.30p (2018: 2.00p), this will give a total ordinary dividend of 6.88p (2018: 5.98p), an increase of 15% on last year.

Following the minority asset disposal, the business will be in a net positive cash position on completion. This will allow us to generate significant additional value for shareholders from our this existing asset base.

I am, therefore, pleased to announce an intended, new and enhanced dividend policy of 25p per share per annum. Effective from 2020, this will be payable in quarterly instalments and will increase with RPI through to 2024. Representing over three times the dividend of 6.88p in 2019, this marks the start of returning materially increased value through distribution to shareholders over the medium term.

Continued investment in sustainability: the environment, our people, and health and safety

With a core Group focus on investment in assets that help reduce carbon, operating sustainably is a key focus area for us and we aim to be transparent with our investors on the impact we are having on both the environment and society around us, and our people.

In 2019, we developed a holistic view of our sustainability, quantifying our positive impacts delivered through our services, and negative impacts from our business estate and fleet. I am very proud to confirm that, in 2019, the positive services we were able to provide significantly outweighed the footprint we left behind, supported by our products and services and efforts to reduce our own footprint through fleet upgrades, property refurbishments and procurement of renewable electricity.

The success of our business is undoubtedly reliant on the continued support of our employees. We put our people first, placing considerable value on their engagement. During 2019, we refined our values and behaviours through a collaborative project, with extensive involvement from employees at all levels. We now have a clear set of values that align with our strategic objectives and future focus. I would like to thank all our employees for their hard work and commitment during the year.

The health and safety of our employees and customers continues to be a key priority. I am pleased to report that our performance over the year remained stable, despite a significant increase in our engineering workforce, with no notable detrimental changes to our accident frequency rates.

Board changes

With the continued growth of the business, and the opportunities ahead, strengthening our Board has never been more important. Having the right set of skills, knowledge and experience is critical in delivering our strategic objectives and, ultimately, generating value for our shareholders.



20%

increase in ILARR

14%

increase in pre-exceptional
EBITDA

CaRe

Board changes continued

I am, therefore, delighted to welcome two new appointments during the year, Tim Mortlock and Ruth Leak.

Tim was appointed as Executive Director and Chief Operating Officer on 17 September 2019. Previously Managing Director of the asset management and energy management divisions, Tim has been with the Group for over 20 years and has extensive knowledge of our business and the wider industry. This appointment represents a significant milestone for our business, and Tim will be instrumental in delivering the next phase of our strategy.

I am also pleased to confirm that we have been able to attract Ruth Leak to the Board, as a new Non-executive Director. An information technology specialist, Ruth most recently served as Chief Information Officer for the Letters and Network division of the Royal Mail. Ruth has taken over as Chair of the Information Technology Committee and brings a greater balance of experience to the Board.

Coronavirus

As the situation continues to evolve, our primary concern is for the welfare of our people. We are following the development of the coronavirus outbreak closely and have implemented several immediate measures to both protect our employees and to prepare for possible consequences of the virus. Whilst the outbreak has not yet had any direct impact on our operations, it is unclear how it will develop. It is currently difficult to assess the potential impact this could have on our 2020 business activities and results but, based on the current financial position of the Group, together with the cash that will be generated upon completion of the asset disposal detailed in note 28(b), we are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. We will continue to follow developments closely and are prepared to take further action as appropriate.

Current trading and outlook

We have demonstrated during the year our resilience in managing the short-term challenges arising from the volatility of the smart meter rollout, whilst addressing future market opportunities through strategic investment and development of our carbon reduction proposition. With the technical issues experienced during 2019 substantially behind us, and support from BEIS in the form of a proposed extended rollout timescale to the end of 2024, we are well placed to progressively deliver the rollout in an efficient manner with our customers.

Capital efficiency remains a key strategic priority for us, ensuring we can effectively respond to market developments, and take advantage of additional opportunities, whilst also increasing shareholder value.

The years ahead hold more exciting developments for our business, with the ongoing smart meter rollout and growth in our CaRe asset base. The Board remains confident in SMS's strength and potential in the face of a transforming energy landscape.

The current year has started in line with the Board's expectations and we continue to actively engage with both existing and potential customers in securing our future order book.

WILLIE MACDIARMID**Non-executive Chairman**

17 March 2020



Secure returns today, supporting sustainable growth tomorrow

Our long-term business model focuses on capital efficiency to support growth in carbon-reducing assets which generates value for all stakeholders.

Net-zero carbon at the heart of our activities

The scale and urgency of global action required for climate change to be addressed has undergone a step-change during 2019. This has resulted in a governmental, business and consumer response that is likely to bring significant market disruption with the UK becoming the first major economy to legislate for net-zero carbon emissions. The impact of this will be especially evident in the energy industry, with long-term structural changes to how and where energy is generated, stored and used.

The UK's net-zero target will continue to drive public policy decisions in our industry, one of which is the need for smart meters. Smart meters are an integral part of a flexible, decentralised and decarbonised energy system – central to reducing CO₂ emissions and reliance on unsustainable energy sources.

Sustainability is therefore at the heart of our business. Central to the government's decision to convert the UK to smart meters is the clear impact that control over energy consumption has on reducing carbon emissions. This macro trend provides substantial opportunities for our business, and with 25 years' experience in the energy industry and a well-established IT, data and engineering platform, SMS is well positioned to take advantage of them and contribute positively towards a sustainable future through the development of CaRe assets that complement and are enabled by smart meters.

Strategy

The industry trends provide a clear direction and substantial opportunity for the continued long-term success of our business, delivering and maintaining both meter and CaRe assets, which provide high-quality and secure recurring revenue streams.

To deliver this, our focus remains on the following three pillars of our strategy, on which we have made strong progress in 2019:

- ▶ securing long-term index-linked sustainable revenue streams;
- ▶ efficient operational delivery and customer excellence; and
- ▶ efficient capital structure to assist in generating shareholder value.

Index-linked revenue streams

The core focus of the Group is securing long-term index-linked, sustainable, recurring revenue streams.

We have clear visibility of our recurring revenue pipeline, with substantial opportunities to grow this further given both the continued growth in the independent energy retail sector to over 30% market share and the c.36.5 million meters still to be exchanged in the industry as a whole.

Operational efficiency and excellence

In 2019 we continued to invest in engineering capacity, meter stock and IT infrastructure to support the transition to SMETS2 and ensure continual improvement in the efficiency, customer service, quality and health and safety standards with which we deliver our services.

Our IT systems are increasingly integrated with our customers', enabling growing numbers of end consumers to book meter installation appointments through their energy suppliers' "apps" and websites, or at any point in which they speak directly to their energy supplier. We continue to implement innovations which minimise and automate the touchpoints we have with end consumers during our established customer journey processes, improving the customer experience and reducing the volume of activity within our contact centre as a result.

These integrations with our customers are also important to co-ordinate customer engagement and conversion with the energy suppliers, who are taking ever greater ownership of that process in the context of regulatory targets for smart meter deployment.

The proposed extended delivery period through to the end of 2024 for the smart meter rollout will mean a smoother rollout profile ahead of us, and we have already taken steps in H2 2019 to improve productivity by increasing the amount of transactional, revenue-generating "callout" activity we provide to energy suppliers.

We will maintain a strong focus on engineering efficiency and cost discipline in 2020, aligning our resource base to the longer rollout profile, whilst ensuring we have the flexibility to ramp up installation rates to meet the significant opportunities ahead.

Capital structure optimisation and shareholder value

Whilst we have sufficient funding to meet our immediate contracted opportunity pipeline, with net debt of c.£220m at 31 December 2019 from a facility, at that time, of £420m, we continually review our financing to ensure we are optimising our capital structure.

We have successfully agreed the conditional disposal of a minority of our I&C portfolio, consisting of £18.4m of I&C ILARR, for £291m gross proceeds to funds managed by Equitix Investment Management Limited. SMS will continue to manage the disposed assets with an average age of c.4.7 years for £0.8m of RPI-linked management fees.

In addition, we have retained a portion of I&C assets and will continue to participate in the I&C market through our utilities connections business. At completion, the disposal generates a net positive cash position for the Group, enables acceleration in dividend policy, enhances ability to maximise future meter ILARR opportunities, demonstrates value of meter assets and provides additional funding flexibility. We are well placed to accelerate both growth and dividends whilst maintaining prudent leverage through the investment cycle.

► Growth funding

We have several funding options which provide significant flexibility to maximise opportunities in the smart metering space: long-term cash generation from our mature meter portfolio (post dividend payments), a revised £300m RCF on attractive terms, incremental cash generated from deployment of new assets and further capital optimisation opportunities.

We have originated a strong pipeline of opportunities in CaRe assets and have partnered with ESIF to provide funds for the development of these assets. SMS's revenues and cash flows from these assets and services are expected to increase over time.

► Sustainable and long-term dividend policy

As part of our recent announcement of a minority asset disposal, we also proposed a revised, sustainable and long-term dividend policy. This starts at 25p per share for 2020, payable quarterly and with a partial scrip alternative, and then growing at least in line with RPI per annum during the meter growth phase to 2024. The dividends are covered by cash generated from our retained existing meter and data assets, providing strong forward visibility. The Board believes there is further dividend upside potential to the dividend policy summarised above.

2019 performance

The business experienced challenges in 2019 during the market's transition from SMETS1 to SMETS2, with industry installation run rates remaining largely flat throughout the year as a consequence. Radio Frequency interference issues in the northern region of the rollout proved a significant impediment to mobilisation of SMETS2 meter installations, whilst the end date for SMETS1 meter installations meant there were no viable alternatives.

“A 20% increase in our key financial metric – ILARR – and a 14% increase in pre-exceptional EBITDA in extremely challenging markets is a testimony to our market position and operational capabilities.”

ALAN FOY

Chief Executive Officer

With these technical issues relating to radio frequency interference now substantially resolved, SMETS2 meters are being installed in increasing volumes. The solution continues to mature as a result, with c.4m SMETS2 meters connected to the network across the industry as of 27 February 2020, although these have largely been fitted by the Big Six UK energy suppliers. The government has consulted to extend the smart meter rollout to December 2024, reflecting a more realistic and pragmatic approach. We believe this provides greater certainty to plan and deliver the rollout in an efficient manner with our customers and expect the rollout profile to be more evenly spread through to 2024 as a result. With compulsory annual installation targets and the introduction of a stricter regulatory regime for energy suppliers, we will continue to work closely with all our customers to mobilise and deliver their rollout requirements.

Some independent energy suppliers are still finalising integrations with the Data Communications Company (DCC) and end-to-end testing, with their readiness to commence mass SMETS2 meter rollouts at varying stages of development.

The industry issues in 2019 led to engineer productivity related challenges, particularly in H1, which had a short-term impact on profitability. Nonetheless, careful management of our operational activities and a strong focus on engineering efficiency enabled us to significantly reduce the impact on profitability. This is a testament to the strength and resilience of our business model that, despite these challenges, the execution of our strategy delivered a robust financial performance highlighted by a growth of 20% in our primary financial KPI – ILARR.

We ended 2019 with £90.1m of ILARR. This growth was primarily driven by the smart meter exchange programme, with recurring revenue from domestic smart meters increasing by 40% in 2019 from £27.1m to £38.1m. We have also continued growth in all our other segments with I&C meters £21.2m (2018: £19.0m) at 31 December 2019, of which £18.4m have been subsequently sold, data assets £12.3m (2018: £12.2m) and traditional domestic meters £18.6m (2018: £17.1m). As we continue to roll out smart meters, recurring revenue from our traditional meters will steadily reduce.

Continued growth and new opportunities

Domestic smart meters and data

We have a contracted order pipeline of c.2 million meters from our independent energy supplier customers which will initially add c.£40m to our ILARR. SMS is also well placed, operationally and financially, to take advantage of additional opportunities which we see beyond this pipeline. We continue to focus on leveraging our valued turnkey services to originate long-term, index-linked return on our capital investment in meter assets.

The rollout of smart meters has created additional data opportunities for SMS. We are focused on growing our data services by launching elective half-hourly settlement and SMETS2 firmware management services for our energy supplier customers. We believe this is a substantial market opportunity in its own right, and the revenues originating from these activities are also index linked and recurring in nature.

CaRe assets

We also see significant growth opportunities in CaRe assets from within our energy management division. Established over the last 25 years, we have developed a strong IT, data and energy platform which, coupled with our end-to-end turnkey solution and industry-wide partnerships, provides us with significant opportunities and competitive advantage.

SMS is well placed to support the UK government's net zero ambition by 2050. We can do this by continuing to leverage our well-established energy services business as the UK transitions to a more sustainable and low-carbon economy. Our partnership with ESIF provides capital support for SMS's identified pipeline and future opportunities of CaRe assets. Such initial CaRe assets include energy efficiency systems (such as LED lighting, data and controls), energy storage, distributed generation, and EV charging infrastructure.

This year marks our 25th anniversary, which is testament to our secure business foundation and long-term business model. We are committed to creating a resilient energy infrastructure for the future, focused on delivering long-term value for all our stakeholders.

ALAN FOY
Chief Executive Officer
17 March 2020



Establishing a business at the centre of the energy system as we transition to a more sustainable and low-carbon economy

	2019 priorities	2019 progress
Index-linked, sustainable revenue streams 	<ul style="list-style-type: none"> ▶ Grow ILARR and smart asset portfolio. ▶ Maintain yield and returns on capital deployed. ▶ Build contracted and opportunity smart meter pipeline. ▶ Invest in foundations for future growth in new asset classes. 	<ul style="list-style-type: none"> ▶ ILARR grown 20% to £90.1m including 40% growth of smart meter portfolio to c.£38m. ▶ Several contract wins added to existing customer base with continued c.2 million smart meter contracted pipeline which should add c.£40m in ILARR. ▶ Continued investment in established profit-contributing energy services business. ▶ Acquisition of Solo Energy, details on page 28.
Operational efficiency and customer excellence 	<ul style="list-style-type: none"> ▶ Safely transition from SMETS1 to SMETS2 meter installation. ▶ Optimise installation capacity. ▶ Improve customer experience and online digital journey. ▶ Drive engineering productivity and efficiency. 	<ul style="list-style-type: none"> ▶ Continual improvement in Health and Safety performance. ▶ Transition to SMETS2 meter installations completed, with technical issues substantially resolved. ▶ Installation capacity maintained during challenging transition, despite resultant productivity challenges. ▶ c.50% of all smart meter appointments now booked online. ▶ Increased transactional “callout” activity supplemented meter installation work to support improvement in productivity during H2.
Efficient capital structure 	<ul style="list-style-type: none"> ▶ Ensure financial capacity to maximise smart meter opportunity. ▶ Manage leverage position carefully, ensuring sufficient headroom on loan covenants. ▶ Preserve cash flows for smart meter market. ▶ Progressively support returns to shareholders. 	<ul style="list-style-type: none"> ▶ £200m of available cash and unused debt facility which, aligned to operational cash generation, provides capacity to deliver contracted order book. ▶ C.£220m net debt, in line with expectations and representing 3.7 x net debt/pre-exceptional EBITDA. ▶ Exploration of the potential disposal of a minority of the Group’s meter assets, to provide further capacity for growth and balance sheet strength. Transaction subsequently conditionally agreed in March 2020 as reported on page 6. ▶ Identification of alternative mechanisms, which will enable new asset classes to be independently funded, resulting in cash positive returns to the Group.

Our strategic framework is split into three key priorities, which are underpinned by our focus on delivering long-term value to our shareholders and ensuring a safe, efficient and productive working environment for our people.

Our continued investment in revenue-generating assets means we are setting the foundations for a secure future and, through this strategy, we are confident we can deliver on our promises to shareholders.

Future priorities and challenges

- ▶ Focus on obtaining additional smart meter ILARR.
- ▶ Maintain return expectations in existing contracts and new opportunities through delivery of our valued turnkey service model.
- ▶ Continue to extend existing framework arrangements with existing customers across wider customer portfolios and extend contracted pipeline.
- ▶ Demonstrate reliability and security of new CaRe asset classes through pilot project deployments.

- ▶ Introduce SMETS2 meter variants and work with all customers to complete DCC integrations and systems testing and mobilise their mass rollouts.
- ▶ Align resource and cost base to the proposed, extended rollout period.
- ▶ Drive efficiency through continued improvements to digital customer journey and automated job scheduling.
- ▶ Dedicated focus on engineering efficiency and cost discipline, with flexibility in direct labour and subcontractor model to increase run rates to support customer requirements.

- ▶ Maintain prudent leverage.
- ▶ Implement a strengthened sustainable dividend policy due to the unlocking of value from the sale of a minority of the Group's meter assets.
- ▶ Optimal capital allocation with cash flows supporting dividends and addressing growth opportunities with attractive returns.
- ▶ Enhance funding flexibility and ensure sufficient capacity to maximise growth opportunities.
- ▶ Secure mechanisms which will enable new asset classes, particularly CaRe assets, to be independently funded, resulting in cash positive returns to the Group.

Strategic developments in early 2020

The Group's primary focus for the foreseeable future will continue to be the UK Domestic smart meter market opportunity. However, SMS intends to continue to ensure it has the capabilities to develop and deliver integrated energy solutions to its customers, both new and existing, by originating CaRe assets including batteries, solar, LED lighting and EV chargers.

Looking beyond 2019, the Group's future strategy is characterised by an enhanced dividend policy and the maximisation of growth opportunities in meter and CaRe assets, whilst maintaining a prudent level of gearing.

The new, proposed enhanced dividend policy is facilitated by the unlocking of value from the sale of a minority of the Group's meter assets in early 2020 and is supported by asset-backed, index-linked, sustainable recurring revenue streams, generated from the Group's meter estate. Overall, it seeks to provide shareholders with an enhanced, long-term and secure dividend payout with further upside potential in the future.

Through this revised strategy, we aim to appropriately balance the needs of our stakeholders with the ongoing capital structure and funding requirements of the Group.

Our integrated service business model for long-term value

What we have

Our strengths

A growing smart meter portfolio

Our meter assets generate highly sustainable, annuity-style cash flows and provide a secure foundation for the future growth of the business. Approximately 30% of all meters covered by the UK smart meter rollout, including domestic and non-domestic, were operating as smart at 31 December 2019, with c.70% still to be exchanged.

Engaged people

We are focused on employee retention, training and development, productivity and, above all, an unwavering commitment to health and safety. We have a nationwide in-house engineering and expert consultancy workforce, with a strong track record of service delivery, which allows us to make smart decisions about all aspects of our customers' projects.

Robust technology platforms

We have significant IT software and data security capabilities and capacity and the ability to develop new applications and technologies to the ongoing benefit of our customers. Delivery of our integrated services is supported by our own central cloud-based IT and data platform.

Long-standing relationships with our customers

With more than two decades of operations, we enjoy multi-level relationships with energy suppliers, developers and enterprises within the UK industrial and commercial sector. The enduring partnerships we maintain with our customers are testament to our unrivalled support, extensive industry knowledge and commitment to providing successful, innovative and forward-thinking energy solutions.

Effective capital management

We continually review our funding position to ensure that we maintain an efficient capital structure, with sufficient capacity and flexibility to maximise growth. Our primary source of debt has been Group-level funding secured on our revenue-generating assets; however, following the contingent disposal of a minority of our meter assets in early 2020, the business has reset its leverage, resulting in a net cash positive position. The Group plans to maintain prudent leverage going forward, using internal cash generation and a revised debt facility to fund our secure order book, with additional mechanisms in place to enable new CaRe asset classes to be independently funded.

What we do



Underpinned by our values

Safety

Innovation

Customer
excellence

Sustainability

Pride

Through our business model, we fulfil our objective to deliver long-term, sustainable value for our stakeholders, whilst also investing efficiently in the future growth of the business.

Who we deliver for

Asset management

Investing in meter and energy infrastructure assets and providing remote reading solutions and other data services, focusing on increasing growth rate of meter assets portfolio and driving recurring revenue.

Asset installation

Direct field force management and asset installation, targeting the domestic smart meter opportunity. Design, installation and management of utility connections and energy infrastructure.

Energy management

Providing energy-efficient strategies with key focus on cross-selling and establishing additional energy-efficient products and services.

See our Operational Review **23–28**

Our long-term priorities

1

Securing long-term index-linked sustainable revenue streams

2

Efficient operational delivery and customer excellence

3

Efficient capital structure to generate shareholder value

Creating value for our stakeholders

Our shareholders

15% increase in dividend per share to 6.88p

We have historically aimed to provide a progressive dividend that shares the rewards of our profitability and growth with shareholders and provides a sustainable return. Following the conditional sale of a minority of our assets in early 2020 we have reset our balance sheet and intend to pay a notably increased dividend from 2020 onwards, supported by asset-backed recurring revenue.

Our customers

We provide an end-to-end service in all aspects of utility infrastructure, smart metering and energy management. This breadth of service makes us unique in our industry, with our expertise allowing our customers to have confidence that we will deliver an appropriate solution.

Our employees

Putting our people first

A motivated workforce encourages creativity and productivity and is critical to the execution of our strategy. We place great importance in creating a positive working environment for all our people, providing interesting and challenging career opportunities that offer staff the chance to develop.

Our partners

We work with a wide range of partners over the long term including suppliers, lenders, government and regulatory bodies. These relationships are crucial in delivering our business model and strategy and maintaining positive and open engagement is a key priority.

The environment

73% renewable electricity purchased in 2019

As a major energy services and smart metering company, sustainability is at the core of our business. Through training and development, the sustainability culture of the business is instilled in all staff from the moment they join the Company.

Market trends

Market opportunities

UK mandated smart meter rollout



- ▶ BEIS announced a proposed extension of the UK smart meter rollout deadline to 31 December 2024 with annual mandatory performance targets to be introduced on a supplier by supplier basis.
- ▶ DCC fully operational – c.4 million SMETS2 meters connected as of 27 February 2020.
- ▶ C.70% of all meters covered by the UK smart meter rollout are still to be exchanged with the industry-wide run rate just over 1 million meters per quarter.
- ▶ DCC Radio Frequency technical issues in northern areas resolved, though some technical meter variants still to be fully deployed. Certain energy suppliers still to fully test volume connectivity to DCC and mobilise mass SMETS2 rollouts.
- ▶ The Enrolment and Adoption programme for SMETS1 meters commenced but was delayed. Key next phase now planned for June 2020.

Disruption in energy retail market



- ▶ The independent energy retail sector has grown to >30% market share.
- ▶ Further market disruption with disposal of one “Big Six” retail business in January 2020 (SSE) to an “independent” energy supplier (Ovo Energy). SSE had c.12% market share.
- ▶ Energy retail price cap on prepayment and standard variable tariffs continues and, alongside competition, provides challenging financial environment for energy retail businesses.
- ▶ Further consolidation is expected, as well as continued exit from the market of some smaller businesses.
- ▶ New time-of-use tariffs and innovative services being developed by energy suppliers.

Net-zero 2050 target



- ▶ Government-legislated target of net-zero carbon emissions by 2050 expected to drive the public policy agenda and consequent business and consumer response.
- ▶ Ofgem set out its decarbonisation action plan, detailing its next steps on an urgent, but decades-long, journey towards net zero.
- ▶ The government’s much-awaited Energy White Paper, which will detail how it intends to achieve net zero, has been delayed (expected H1 2020).

Electrification of transport and heat



- ▶ Government target for all new vehicles to be electric by 2035, with a ban on the sale of new petrol, diesel and hybrid vehicles due to be enforced accordingly.
- ▶ The government’s Road to Zero strategy includes legislation designed to improve EV uptake.
- ▶ Ofgem has set out its decarbonisation action plan to identify and tackle regulatory barriers, and remove obstacles to new business models, products and services.
- ▶ Decarbonising heating is a big challenge facing the energy sector with residential heating alone currently responsible for c.18% of the UK’s greenhouse gas emissions.
- ▶ The UK government plans to publish a Low Carbon Heat Roadmap in 2020 and, along with the expected Energy White Paper, this should provide some direction for the future.

Technology driving change



- ▶ Digitisation of energy.
- ▶ Volume of data being generated by smart meters and other devices.
- ▶ Technology being used to drive efficiency and enhance customer experience.
- ▶ Digital revolution driving a more dynamic energy system, with demand and generation needing to be able to respond to each other on a local basis.
- ▶ Artificial intelligence, automation and use of blockchain have potential to further disrupt the energy market.

As the landscape of the UK energy market is rapidly changing, it is key that we are aware of, and can respond to, current issues and emerging trends. These are discussed in further detail below.

SMS response

- ▶ SMS expects a smoother installation profile and is focused on productivity, efficiency and aligning its engineering resource base to the longer rollout profile with sufficient flexibility built into its operational model to meet peaks of demand, supported by its in-house training academy.
 - ▶ We continue to work with all our customers to fully mobilise SMETS2 rollouts and meet their regulatory obligations, with considerable technical experience and our own test labs in our training academy to support end-to-end testing across all meter and firmware types.
 - ▶ We continue to support DCC with test lab services, supporting the acceleration of the Enrolment and Adoption programme, and also with all energy suppliers to ensure they bring forward all SMETS1 meters for enrolment and adoption in line with their obligations from June 2020.
-
- ▶ SMS's primary relationships are in the Domestic market with "independent" energy suppliers, and we therefore see the opportunity to grow with this market segment.
 - ▶ Competitive long-term index-linked rental arrangements provide lowest-cost rental for suppliers and long-term opex cost certainty.
 - ▶ SMS has focused credit control to ensure timely collection of rental revenue streams, minimising exposure further. This is also mitigated by Ofgem's Supplier of Last Resort process.
 - ▶ Active engagement with suppliers onto whom SMS meter assets have churned, to secure formal, contracted arrangements.
-
- ▶ We have an established energy services business, which already helps businesses to reduce their carbon footprints and execute greater control over the generation, use and storage of energy.
 - ▶ We have partnered with an infrastructure fund to provide capital support for SMS's identified pipeline and future opportunities of CaRe assets.
 - ▶ An Environmental, Social and Governance (ESG) Committee is in the process of being established.
 - ▶ We nurture a culture that empowers safety and sustainability on an individual and organisation-wide level. See our Sustainability Report on pages 34 to 43 for further details.
-
- ▶ SMS has obtained accreditation from the Office for Low Emission Vehicles (OLEV) as an EV installer, enabling us to support our customers to deploy the required EV infrastructure at a domestic, on-street and business level.
 - ▶ SMS is lead co-ordinator in the Virgin Media Park and Charge (VPACH) project, a UK government-funded scheme which aims to demonstrate the opportunity to build a fully integrated, scalable and timely EV charging network for on-street residential parking including a trial of 1,200 such charging points.
 - ▶ SMS is a lead partner on the REMeDY project, a UK government-backed development that aims to establish a local, decentralised, automated energy system for the city of Southend (but which is replicable across the country), integrating artificial intelligence and IoT technologies with zero-carbon solutions across electricity, mobility and heat.
 - ▶ SMS training academy and national installation platform able to support mass infrastructure-scale deployment of low-carbon assets, such as EV charging points, battery storage and local generation.
-
- ▶ Provision of firmware management services to energy suppliers to manage SMETS2 devices and their integration with other energy asset classes (such as EV charging points).
 - ▶ Expansion of data services, to encompass half-hourly settlement of domestic data from smart meters on behalf of energy suppliers, facilitating the design of smart time-of-use/dynamic tariffs.
 - ▶ Investment in cloud infrastructure and cyber security to provide integrated digital asset management and deployment platforms. See our Operational Review on pages 23 to 28 for details on our acquisition of Solo Energy.
 - ▶ SMS is a lead partner in the Orkney-based ReFLEX project; a major project aiming to digitally link renewable generation with consumer demand, eventually eliminating the need for fossil fuels.


Stakeholder engagement

Stakeholder engagement is critical to the long-term success and sustainability of our business. It is the process by which we develop our knowledge and understanding of each stakeholder group (as detailed below) and the key drivers for each of them in their interaction with our business. We have proactively sought to maintain open, engaged and transparent dialogue with all stakeholder groups during 2019 and this has led to an enhanced understanding by us of their key concerns, which we have embedded within Board, and Committee, discussions held throughout the year.





Our key stakeholder groups include, but are not limited to, shareholders, customers, employees, suppliers, lenders/financiers, government bodies and regulatory bodies.



Non-exhaustive examples of the continuous dialogue we have had with stakeholder groups during 2019 are detailed below and on pages 19 to 21. These examples demonstrate the considerations of the Directors with regard to the matters detailed in sections 172(1)(a) to (f) of the Companies Act 2006 (the 2006 Act) and they form the Directors' statement required under section 414CZA of the 2006 Act.

The Board has resolved to further enhance the existing framework for stakeholder engagement during 2020 to ensure that it remains robust and, within the decision-making processes of the Board, encapsulates a consideration of the impact of strategic and operational decisions on stakeholders.



Stakeholder group	Reason for engagement	Form of engagement	Key topics of engagement during 2019
Shareholders  <p>Please refer to the Corporate Governance Report for details of shareholders</p> <p>52–58</p>	<p>SMS utilises capital to originate sustainable, long-term assets, for which shareholder support is crucial.</p> <p>The long-term strategic plans for the business necessitate strong relations with, and support from, shareholders and we endeavour to keep shareholders regularly updated on these plans during the course of each year.</p> <p>We are ultimately seeking to promote an investor base that is interested in a long-term holding in the Company and the generation of safe and secure dividends.</p>	<p>Our programme for investor engagement is detailed in the Corporate Governance Report on pages 57 to 58.</p> <p>The key methods of communicating with shareholders are as follows:</p> <ul style="list-style-type: none"> ▶ discussions held during the Annual General Meeting (AGM); ▶ investor roadshows following the announcement of the half-year and full-year results; ▶ continuous availability of the Chairman to discuss matters of concern; ▶ ad hoc meetings between institutional shareholders and the Chief Executive Officer, Chief Financial Officer and Chief Operating Officer; and ▶ a Capital Markets Day. 	<p>With an increased focus in the market on sustainability, we convened several sessions during 2019 with key shareholders on our Environmental, Social and Governance (ESG) initiatives. Our ESG initiatives and credentials are detailed in our Sustainability Report on pages 34 to 37.</p> <p>Following feedback from shareholders, the Board has decided to host our first ever Capital Markets Day in 2020. This will be a forum for the Executive team to give an update on the strategy and development of the SMS Group and its strategy and operations.</p> <p>We maintained open and effective engagement with investors on key topics such as strategy, governance and business performance during 2019.</p>



Stakeholder group	Reason for engagement	Form of engagement	Key topics of engagement during 2019
Customers 	<p>In order to:</p> <ul style="list-style-type: none"> ▶ maintain our reputation for excellence within the metering industry; and ▶ remain commercially competitive and secure further lucrative long-term contracts which, in turn, further service our relations with shareholders, <p>we strive to maintain open and honest relationships with our customers.</p> <p>As the energy and utilities industry navigates the UK smart meter rollout, and the inherent volatility arising from it, it is important that we work collaboratively with energy suppliers to ensure we are meeting their service needs in an efficient and effective way.</p> <p>We aim to provide exceptional customer service and deliver long-lasting customer satisfaction. We seek to become an extension of their business, rather than an outsource partner.</p>	<p>SMS always aims to exceed customer expectations. This means having the ability to listen and respond to customer feedback.</p> <p>We have clear and structured lines of engagement for our core customer groups and all customers are assigned an account manager – a single point of contact with whom items can be discussed. For larger customers, dedicated contact centres are used to co-ordinate with end consumers.</p> <p>Separate specialist teams are allocated for planning and scheduling, commercial billing and general account management, ensuring regular communication is maintained.</p> <p>We also endeavour to execute regular service reviews to ensure we are addressing feedback from customers in a timely manner.</p>	<p>As the UK smart meter rollout has progressed during 2019, there has been an increased demand from our customers for support and guidance regarding the technical developments that have been made. In response to this, we met with key customers, and ran several technical workshops for energy suppliers, addressing the key technical components of the second-generation smart meter (SMETS2), and steps required to get “SMETS2 ready”.</p> <p>The rollout of the SMETS2 meter has crystallised the requirement of the energy supplier to have clear, contractual arrangements in place. In response to this, we have actively engaged with our non-contracted customers to review and, where relevant, update their underlying contractual arrangements.</p> <p>Lastly, we have worked closely with our larger customers in 2019 to understand their information technology requirements and integrate these with our key systems so that we can efficiently deliver their installation plans.</p>
Employees  <p>Please refer to the Sustainability Report for details</p>  	<p>Our experienced and dedicated workforce is a key asset to the business.</p> <p>We believe that happy employees encourage creativity, productivity and cost efficiencies, which are key in allowing us to execute our strategy and achieve our mission.</p> <p>It is therefore crucial that we create the right environment, leading by example and providing suitable development opportunities for staff at all levels.</p>	<p>We have an open and collaborative management structure. This tone is set from the top by our Executive Directors and is encouraged downwards throughout the organisation. A designated Non-executive Director provides independent oversight over employee engagement.</p> <p>Engagement with employees is maintained through our intranet site, the issuance of regular newsletters, ad-hoc Company presentations by the Executive Management Team and our various wellbeing initiatives.</p> <p>The Board's framework for engagement with the workforce is currently under review and 2020 will hopefully see several enhancements, including the introduction of a more structured appraisal process across the Group.</p>	<p>Our workforce was engaged on several significant projects during the year. Through discussion forums, their thoughts and feedback were collated and evaluated, and they directly influenced the key outputs.</p> <p>2019 projects included:</p> <ul style="list-style-type: none"> ▶ a contract review of terms and conditions of employment to standardise our terms of employment; ▶ the design and implementation of a refined set of values and behaviours to reflect the strategic positioning of the business and our future focus; and ▶ the design and deployment of a new interactive corporate induction programme, which involves participation in video from current employees.

Stakeholder group	Reason for engagement	Form of engagement	Key topics of engagement during 2019
Suppliers 	<p>Our wide range of partners provides us with the goods and services we rely on to deliver for our customers; this includes physical plant and equipment – most notably meter assets – engineering services and legal and professional consultancy, to name but a few.</p> <p>Reliable supplier relationships are thus crucial in delivering our business model and strategy. Maintaining positive and open engagement is a key priority.</p> <p>Health and safety is at the heart of everything we do and this extends to services provided to us by our third-party partners.</p>	<p>Suppliers are engaged and onboarded by skilled procurement and legal professionals, using Group-wide procurement procedures and policies.</p> <p>Our thorough onboarding process helps us minimise risk in areas such as: ethics, quality and supply chain security.</p> <p>Once onboarded, a two-way communication process is maintained and prompt payment practices are followed. With larger suppliers there is ongoing engagement through regular meetings and feedback sessions and performance may be measured against key performance indicators.</p> <p>Where relevant, thorough tender and bid processes are carried out.</p>	<p>During 2019 we have continued our efforts to ensure that all manner of suppliers have been successfully onboarded and entered into contractual arrangements with us for the provision of goods and/or services.</p> <p>We regularly participated in competitive tender processes during 2019 which led to several successful appointments.</p>
Lenders/financiers 	<p>Our banking financiers are a critical long-term stakeholder group to the business, and we have continued to maintain strong and collaborative relationships within our syndicate of lenders.</p> <p>The strength of this relationship has fostered an open and transparent dialogue over the years, and this continued throughout the course of 2019.</p>	<p>We maintain regular and robust communication with our financiers through the provision of quarterly financial and management reporting and regular meetings to ensure that they remain fully informed on all areas of the business.</p> <p>The proactive approach we have adopted with this relationship has allowed us to secure its ongoing support in implementing the operational and strategic goals for the business.</p>	<p>The CFO engaged with all lenders, both individually and collectively, to discuss changes to the business, including key strategic projects that require lender's consent and details on potential new contracts that could impact our working capital and capex requirements.</p> <p>The Board's early engagement with its financiers on projects and business changes helps ensure the relationship is maintained. Feedback received from lenders also influences the Board's decision making in shaping the business and adhering to the Group's strategic objectives.</p>



Stakeholder group	Reason for engagement	Form of engagement	Key topics of engagement during 2019
Government bodies 	<p>We engage with several government bodies including the Department for Business, Energy & Industrial Strategy (BEIS) and the Smart DCC Limited (DCC).</p> <p>These government bodies utilise our expertise and experience to assist in the formulation and delivery of key energy policies, which have a direct impact upon our customers and our own business.</p> <p>We maintain an open and transparent dialogue and develop an awareness of the key decisions being made within the industry, which are likely to impact our business. This engagement allows us to forward-plan and remain competitive.</p> <p>In maintaining a collaborative working relationship with this stakeholder group, we are also fulfilling a sustainability responsibility in helping to deliver the future of the smart energy revolution.</p>	<p>We engage with BEIS through a regular meeting programme, including attendance at round tables and working groups. We collate and represent the views of our customers – being energy suppliers which are subject to the UK smart meter rollout and, under their licence conditions, have various legal and regulatory obligations to comply with.</p> <p>We review and provide formal responses on consultations issued by BEIS and other government bodies. Our feedback is typically used to help define programmes of work and potential changes in policy.</p> <p>Our engagement with the DCC is extensive, supported by the assignment of a dedicated relationship manager. In addition, we have representation on both the Smart Energy Code (SEC) panel and Smart Meter Device Assurance (SMDA) Scheme. Through these, we help govern the activities of the DCC and hold programme suppliers to account.</p>	<p>Our interactions with DCC and BEIS have been frequent during the course of 2019, as we have attempted to address the various technical challenges which arose following the introduction of SMETS2 and the enrolment and adoption of SMETS1 meters. The conclusion has been an assessment of forward-looking policies to address the issues.</p> <p>Through contributions into working groups and technical support, we assisted the DCC in addressing the Radio Frequency interference issue that arose in the first half of the year and caused smart meter compatibility issues in specific regions. We subsequently responded to the DCC's consultation on the derogation mechanism used to help manage this issue.</p> <p>We have also provided formal responses on several other consultations, most notably:</p> <ul style="list-style-type: none"> ▶ the plan for SMETS1 Enrolment and Adoption (E&A) into the DCC services, critical for the Group in reducing our exposure to energy suppliers removing SMETS1 meters from the wall early instead of waiting for E&A, and ultimately ensuring these meters remain fit for purpose; and ▶ to confirm our support of BEIS's consultation on a smart meter policy framework post 2020, which included the proposal to introduce a revised monitoring framework with binding pre-set annual milestones for four years through to 2024.
Regulatory bodies 	<p>The primary government regulator for the gas and electricity market in Great Britain is the Office of Gas and Electricity Markets (Ofgem). Ofgem is the regulatory body by which our key customers are governed.</p> <p>In conjunction with other associations, groups and alliances, Ofgem provides comprehensive industry codes of practice that govern the operational, technical and health and safety issues associated with the installation and management of metering assets, and which both SMS and its customers must adhere to.</p> <p>Maintaining regulatory compliance is crucial to our business success amongst customers who place substantial reliance on our reputation as a full-service provider.</p>	<p>We attend regular meetings and respond to, and actively participate in, consultations and workshops in order to remain up to date on regulatory considerations.</p> <p>We have representation on several boards and panels, including: Meter Asset Manager Code of Practice (MAMCoP) and Meter Operator Code of Practice (MOCOPA) panels, the Supply Point Administration Agreement (SPPA) panel, the Association of Meter Operators and the Smart Metering Operations Group.</p> <p>We are subject to regular compliance reviews and audits, both internally and externally, in respect of the certifications and accreditations which we hold under MAMCoP and MOCOPA, amongst others.</p>	<p>We have participated in various discussions during the year, particularly regarding technical and operational matters arising from the installation of SMETS2 meters and the ongoing challenges faced by the industry in overcoming these.</p> <p>Overall, however, there have been no significant regulatory changes to note.</p> <p>Recurring annual audits were carried out with successful outcomes and no identified material non-compliance issues.</p>

Principal decisions

Principal decisions are those operational and strategic decisions which the Board made during the course of 2019 and which are considered to be material to:

(a) The SMS corporate group

In respect of the SMS corporate group, this process is streamlined by the fact that the directors of SMS and the subsidiary boards are comprised of the same individuals; therefore, decision making is relatively straightforward in practice, albeit subsidiary directors still pay due consideration to all decisions being made from the perspective of each legal entity.

(b) Stakeholder groups

The table on pages 18 to 21 details how we established and defined our stakeholder groups. Below, we have provided examples of how, in making principal decisions, the Board duly considered the impact upon them during the course of 2019.

1

Acquisition of Solo Energy Limited

The decision was made to acquire 100% of the share capital of Solo Energy Limited ("Solo"), a Virtual Power Plant facilitator detailed further in the Operational Review on page 28.

In making the decision, the Directors were presented with a comprehensive investment case, which concluded that Solo was a strong strategic fit for inclusion within the Group, sharing a similar vision of enabling low carbon energy infrastructure. Solo's customer base will consist primarily of energy suppliers and grid distributors and aligns with that of the Group's asset management business. Existing experience can thus be leveraged to develop new relationships and secure a broader customer base.

As Solo was a pre-revenue company at the point of acquisition, the Directors considered the potential risks associated with this. Financial models were analysed regarding the likely level of future funding required from SMS to enable Solo's technology platform to reach full commercial scale. Group forecasts, and existing funding arrangements, were considered in ensuring the Group had the financial flexibility to make such an investment. The potential to establish new long-term revenue streams, enabled by smart meters, was agreed to be significant; however, in order to mitigate the potential risk inherent in the early stage nature of Solo, the Directors agreed that the size of the initial investment would be restricted and further capital would only be committed to those projects that could be proven as technically and commercially feasible.

By reaching these strategic conclusions, the Group's key stakeholders – notably shareholders and employees – are not considered to be placed at risk. Solo's operational and commercial activities will be closely monitored through 2020.

2

Board appointments

As set out in the Chairman's Statement and Nomination Committee report, the Board chose to appoint two new Directors in the year. As a result of the continued growth and development of the Group, the composition of the Board was reviewed in order to ensure it remained fit for purpose in leading the Company, and its employees, into the next phase in realising its vision.

Following this review process, the appointment of a Chief Operating Officer was considered appropriate, together with an additional Non-executive Director following the resignation of a Non-executive Director in the prior year.

In assessing the appointment of a Chief Operating Officer, there was considered to be a clear advantage in appointing an internal, dedicated member of senior management; someone with existing, strong relationships with several key stakeholder groups, including customers, suppliers, government and regulatory bodies.

During our engagement with investors, the Group's infrastructure and technology platforms are a common topic of discussion, with a focus on the change that technology is driving in the energy industry. There was therefore careful consideration in ensuring that the Non-executive Director appointment was an information technology specialist, suitably positioned to help the Group respond to this.



Delivering our turnkey integrated service

We have continued to focus on growing our secure, long-term, index-linked revenue streams.

Asset management division

Summary	2019	2018	Growth
ILARR	£90.1m	£75.3m	+20%
Revenue	£82.9m	£65.5m	+27%
Depreciation adjusted cost of sales*	(£5.9m)	(£5.4m)	+10%
Depreciation adjusted gross profit	£77.0m	£60.1m	+28%
Depreciation adjusted gross margin	93%	92%	+1%
Capex on meters	£95.2m	£128.2m	-26%

* Excludes depreciation on revenue-generating assets, recognised within cost of sales. Refer to the Financial Review for definitions and details on the Group's alternative performance measures.

Our focus

The asset management division is focused on growing our secure, long-term, index-linked and sustainable revenue streams. Our primary strategic objectives are to:

- ▶ grow our ILARR, focused on recurring rental from the UK smart metering market opportunity;
- ▶ manage and track all assets through their life, controlling capital deployment and return on investment; and
- ▶ continually ensure a capital-efficient structure, to maximise the opportunity available to us from the smart meter rollout.

Through our industry accredited services, we continue to work with energy suppliers to support them in managing the challenges and opportunities smart metering brings. For example, by growing our data and accredited industry settlement (half-hourly data) services and providing firmware management test labs and services for SMETS2 meters. These are opportunities for us to continue to grow our ILARR, and to play a critical role in the realisation of the smart energy grid, and a greener, low-carbon energy network.

Performance summary

- ▶ ILARR increased by £14.8m, a 20% increase, to £90.1m.
- ▶ Our mature I&C and smart meter asset portfolios contributed £59.2m to the ILARR, with our smart meter portfolio growing 44% to over 1.2 million meters.
- ▶ Further opportunity beyond this pipeline with contracted and potential customers.
- ▶ Focus on capital efficient structures, ensuring sufficient financial capacity to maximise opportunities in the smart meter rollout whilst delivering secure and growing dividends for the long term.

Our smart meter portfolio grew 44% to 1.2 million meters, adding 369,000 smart meters in the year (300,000 from our own installation activity), and we expect installation run rates to be more evenly spread following the BEIS extension of the smart meter rollout to 2024.

Asset management division *continued*

Performance summary *continued*

Data recurring revenue is in line with last year at £12.3m (2018: £12.2m). This reflects the maturity of the I&C market where we predominantly provide these services and our decision to step back from some domestic data services, which require low-margin transactional meter-read activity. We believe there is still an opportunity for data services, both in the I&C and Domestic markets, particularly in supporting energy suppliers with the settlement of half-hourly data from smart meters (which does not require manual meter readings).

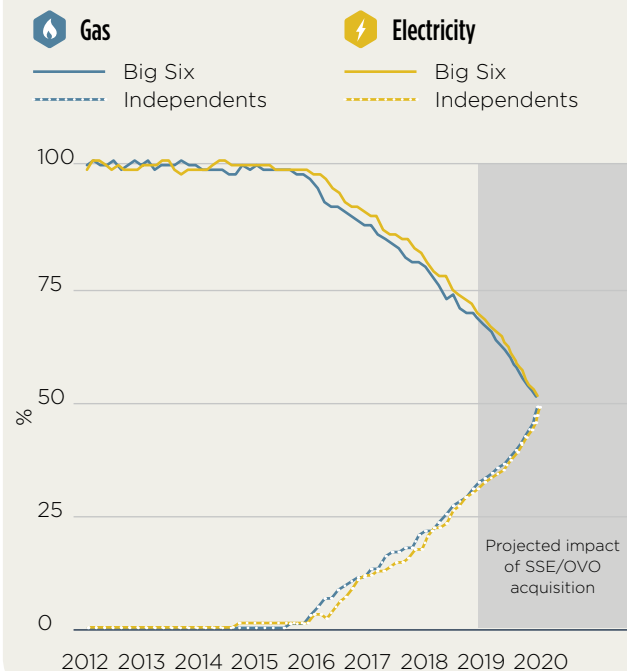
Market conditions

Whilst there have been pressures on the deployment of smart meters, the broader market continues to transform at a rapid pace, with continued growth in the “independent” energy supplier market, which now supplies over 30% of all customers. This was before the recent acquisition of the SSE domestic retail business by Ovo Energy, which had c.12% market share. The independent market segment with which SMS is most heavily engaged benefits from our turnkey approach including both installation and active asset management. There are significant opportunities for us to grow our market share beyond our contracted order book.

We have continued to see some smaller energy suppliers struggle financially. In some cases, Ofgem’s Supplier of Last Resort (SoLR) has been implemented and, as a result, there has been further consolidation in the market. This brings a small amount of risk to SMS in respect of short-term credit risk to rental payments from energy suppliers. However, the SoLR process has proven that, where a more creditworthy supplier is appointed to take over a supplier portfolio, then we have a standard industry process that transfers our meter points to the new supplier and protects our rental revenue streams going forward. Over the life of these long-term assets and on a portfolio basis, this provides a secure backdrop to the significant capital we deploy.

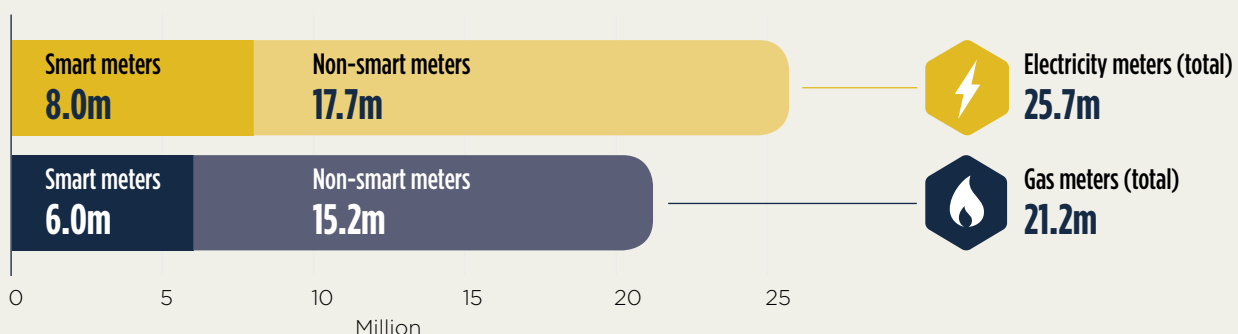
Our well-established turnkey integrated service remains unique in the market and is a strong foundation for our continued growth. We see competition in the market from other asset financing businesses, and some energy suppliers using the smart meter rollout extension to segregate some parts of the delivery process – most notably taking greater ownership over the customer journey.

Graph 1: Supply market shares by company: Domestic (GB)



Source: <https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

Graph 2: Number of domestic meters operated by large energy suppliers in Q3 2019



Source: Energy suppliers reporting to BEIS.

Asset installation division

Summary	2019	2018	Growth
Revenue (external)	£22.4m	£26.6m	-16%
Cost of sales	(£28.0m)	(£20.5m)	-37%
Gross (loss)/profit	(£5.6m)	£6.1m	-193%
Gross margin	(25%)	23%	-48%
Net portfolio additions – smart and I&C meters*	313,000	449,000	-30%

* Net portfolio additions include removals. 2019 net portfolio additions of 313,000 exclude 69,000 smart meters acquired from a customer during the year.

Our focus

The installation division is focused on operational excellence and efficiency. Our primary strategic objectives are to:

- ▶ safely deliver the installation of meter assets which provide long-term recurring revenue to our business;
- ▶ align our engineering capacity and installation profile over the proposed, extended BEIS rollout period, using technology to drive efficiency improvements and an improved customer experience and appointment booking process; and
- ▶ reduce the carbon footprint of our delivery – in particular, from our vans by implementing more dynamic scheduling and introducing electric vans where practical.

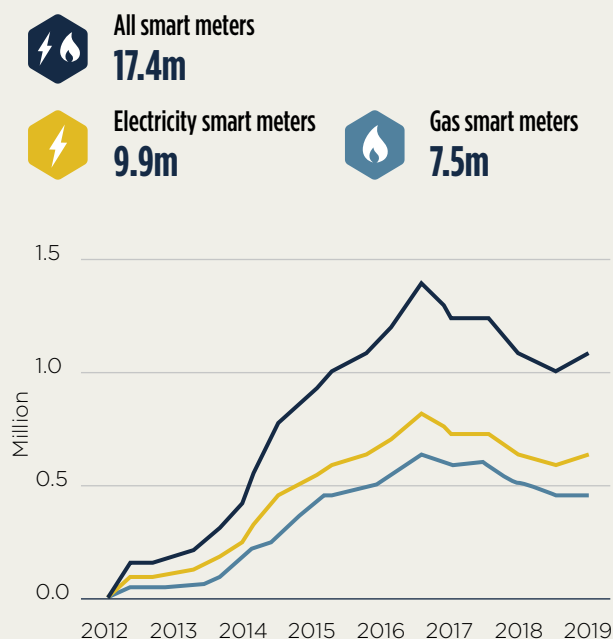
The installation division is working with our customers to trial the installation of next-generation asset classes, in particular smart home and domestic EV charging point devices which can be installed at the same time as smart meter installations.

Performance summary

- ▶ Completed operational, technology and supply chain transition from SMETS1 to SMETS2 in 2019 and supported investment in capacity platform.
- ▶ Technology enhancements that provide online supplier booking portals, to increase portfolio conversion and reduce operational expenditure.
- ▶ Successful navigation through third-party challenges e.g. Radio Frequency interference issues in northern region resolved and SMETS2 meters being deployed on a national basis.
- ▶ Maintenance of a reliable engineering resource base, supported by in-house training academy.
- ▶ Continual productivity improvements in H2, supported by increase in chargeable transactional activity.
- ▶ BEIS consultation, proposing an extension to 31 December 2024, means SMS expects a smoother installation profile, with engineering business being sized accordingly and sufficient flexibility through supply chain to manage peak demands.
- ▶ Working closely with domestic and small I&C energy suppliers to meet rollout obligations.

Graph 3: Number of domestic smart meters installed by large energy suppliers, by fuel type and quarter

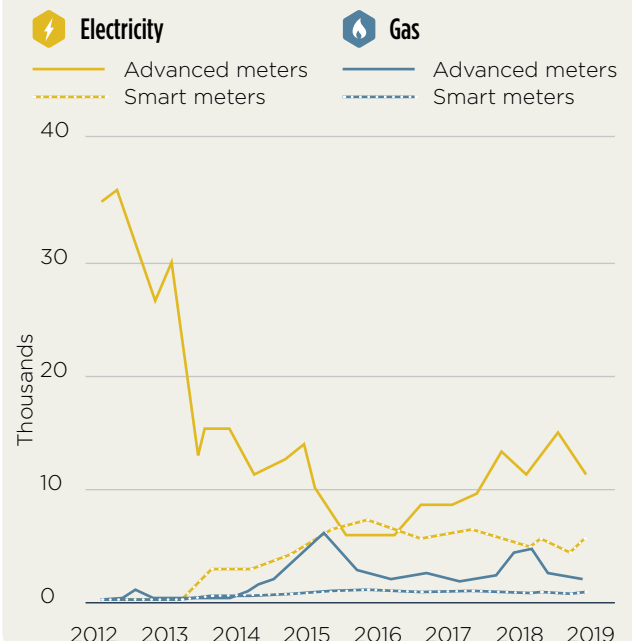
Q3 2012 to Q3 2019



Source: Energy suppliers reporting to BEIS.

Graph 4: Number of non-domestic smart and advanced meters installed by large energy suppliers, by fuel type and quarter

Q3 2012 to Q3 2019



Asset installation division continued

Performance summary continued

2019 was a challenging year for the smart meter installation market, with the government having mandated an end date for SMETS1, effectively enforcing a transition to SMETS2. This was then followed by a technical “Radio Frequency” interference issue with the SMETS2 meter installations – which connect immediately to the central DCC – leading to the inhibition of installations, most notably in the north of England and Scotland.

In addition, each energy supplier’s readiness for SMETS2 has varied, in particular regarding their end-to-end connectivity to the DCC to enable smart meters to be installed and commissioned. The largest “Big Six” suppliers have typically been the most advanced, with some independent energy suppliers, particularly the small and medium-sized ones, still some way behind.

Overall, therefore, the industry has seen a slow-down in smart meter installations in the year, as seen in graphs 3 and 4 on page 25. These show the installation profile from Q3 2012 to Q3 2019 for domestic and small non-domestic smart meters respectively.

Therefore, whilst SMS has had the engineering capacity to fulfil initially forecasted customer demand during 2019, actual installation numbers and hence productivity have proven to be challenging. This resulted in smart meter installations remaining relatively flat over the year.

Working closely with our customers and supply chain, these radio frequency technical issues have been resolved. In addition, we have continued to collaborate with all our customers to ensure their systems and DCC connectivity are fully operational for the mass rollout. We have also taken steps throughout 2019 to address the productivity challenges, particularly increasing the volume of chargeable transactional activity in the second half of the year.

Whilst some technical challenges remain, predominantly around the use of SMETS2 meters in prepayment situations, firmware versions and availability of meter variants, DCC and SMETS2 are increasing in maturity and reliability. We are increasingly optimistic regarding the continued deployment of these solutions through the smart meter rollout – with c.36.5 million smart meters still to be exchanged across the industry by 2024.

Market conditions

The BEIS consultation on the smart meter rollout proposed extending the rollout to 31 December 2024 with a target of 85% of all meters being exchanged by this point. It has also indicated an intended stronger underlying regulatory regime.

Energy suppliers were initially obliged to take all reasonable steps to offer and deliver smart meters to all customers by the end of 2020, whereas now they have to meet annual compulsory targets in order to adhere to the revised programme end date.

This proposed extension reaffirms the importance of the smart meter rollout to the future of the UK energy system. We now expect to see a smoother installation profile through the course of the rollout and are sizing our engineering business accordingly to deliver our contracted meter installation pipeline. This includes allowing sufficient flexibility in our model to meet customer peak demand and additional opportunities from existing and potential new customers.

Through our accredited training academy, we are engaged in industry-wide initiatives to continually improve health and safety (H&S) performance, with smart meter installations providing an ideal opportunity to identify any existing quality issues in the meter or the incoming electrical/gas supply.

Energy management division

Summary	2019	2018	Growth
Revenue	£9.0m	£6.5m	+39%
COS	(£6.8m)	(£5.1m)	+35%
Gross profit	£2.2m	£1.4m	+58%
Gross margin	24%	21%	+3%
Value of utilities under management	£320m	£250m	+28%

Our focus

The well-established energy management division is focused on deploying assets and solutions which help our customers reduce their energy consumption and carbon footprints, thereby helping them in their journey to net zero. Our primary strategic objectives are to:

- ▶ build and deliver a capital project pipeline to deploy services and assets to reduce our customers’ carbon footprints;
- ▶ generate long-term, secure recurring returns from energy efficiency, distributed generation, storage and EV charging projects; and
- ▶ partner with multiple distribution channels to maximise this project pipeline opportunity.

A strong pipeline of CaRe opportunities has been identified based on ongoing trials and projects, which are at various stages of discussions. Through our new funding partnership with ESIF, we are able to deploy capital into these CaRe projects without diverting the cash flows from our meter assets business, resulting in cash positive returns to the Group.

SMS’s revenues and cash flows from CaRe assets and services are expected to increase over time, with no funding obligation and no significant cost needed to accelerate growth. This provides an additional lever for further rebasing of future dividends.

Performance summary

- ▶ Revenue and gross profit increased in line with expectations from delivery of energy efficiency strategies and energy management services.
- ▶ Strategic positioning to deliver capital projects which improve energy efficiency and reduce carbon emissions, through investment in new generation, storage, electric vehicle assets and energy services projects.
- ▶ Investment in Solo Energy, with “FlexiGrid” technology platform which integrates distributed generation, battery storage and EV chargers across domestic and commercial buildings to create a virtual power plant (VPP).
- ▶ This VPP enables SMS to control and manage the long-term revenue streams from these new asset classes.
- ▶ Industrial expertise, customer relationships and extensive, highly skilled engineering base demonstrated through long-term blue-chip customer relationships.

Our energy management division has performed well in 2019, continuing to specialise in working with I&C customers, particularly those with large, complex, multi-site portfolios. We advise on and implement effective strategies that reduce both energy costs and consumption, by providing a full range of energy consultancy services, including bill investigation, bureau, energy reduction and environmental management.

Our approach is built on data, using our data analytics platforms and often working closely with our accredited industry data services, to identify opportunities to reduce our customers’ carbon footprints.

We have continued in 2019 to deliver several capital projects, funded by customers, which reduce energy intensity, such as an LED lighting project and smart controls project for a major UK hotel chain. We have a strong pipeline of activity and other similar projects which have a positive outlook for the continued growth of these services in coming years, intended to be funded through our infrastructure fund partnership.

We have established a full turnkey end-to-end delivery, supported by strong industry relationships. The increased urgency to address net-zero greenhouse gas emissions provides substantial opportunity for our business.

Future energy scenarios



Over 7 million hybrid heat pumps could be installed by 2050 with gas providing continued flexibility.



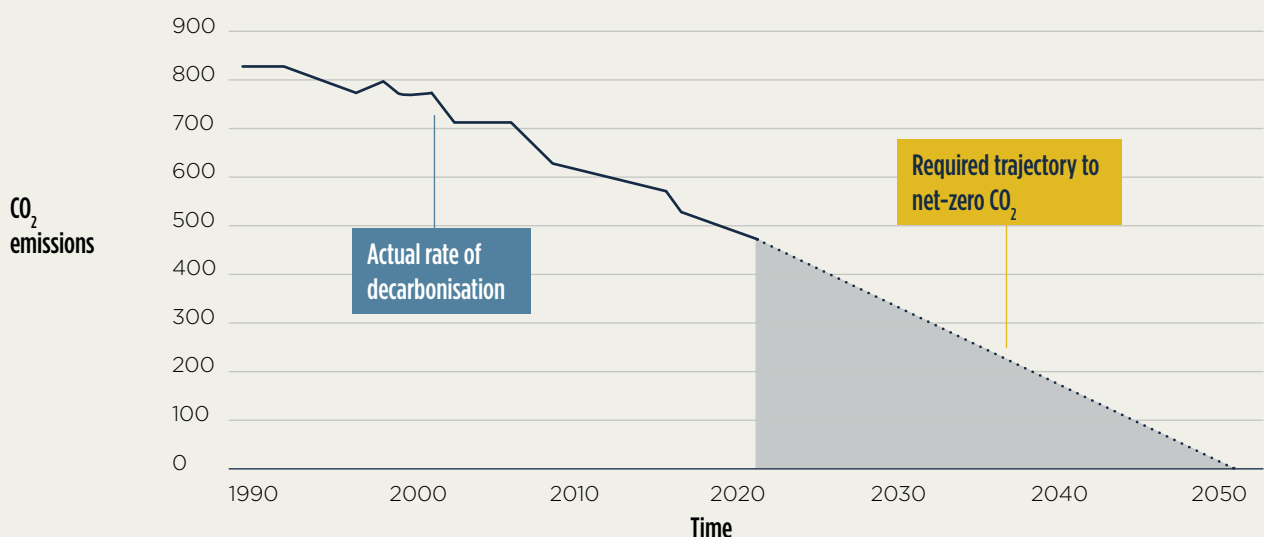
Smart charging vehicles could enable the storage of roughly one-fifth of GB’s solar generation for when this energy is needed.



Well over 2.8 trillion data points will be collected in 2050 to understand where EVs are charging on the electricity system.

Source: National Grid, Future Energy Scenarios 2019.

The UK’s decarbonisation journey



Source: BEIS (2020) Final UK Greenhouse Gas Emissions 2018.

Energy management division continued

Market conditions

There are several factors driving the emergence of smart technologies and a new way of delivering and using energy including:

- ▶ the ongoing digitisation of our energy system;
- ▶ the introduction of the net-zero carbon target for 2050;
- ▶ the resulting renewed public policy focus on the climate change agenda; and
- ▶ the rapidly shifting business, consumer and investor sentiment.

Energy efficiency remains the first and most important step in this hierarchy. However, this data-driven transformation is expected to have a profound impact on how and where we generate, store and use energy – making it more dynamic, connected and sustainable. In particular, the necessity for increasing levels of renewable generation and peak electric vehicle charging demand (especially at the local level) requires new assets, capital investment and software data controls platforms to respond to energy and price signals.

Whilst smart meters are at the heart of this transformation, by enabling two-way flow of energy and smart and dynamic time-of-use tariffs, SMS has the proven knowledge and platform to work with end customers and energy suppliers to deliver these new asset classes.

Our investment in Solo Energy also provides us with a cloud-based energy flexibility IT platform – FlexiGrid – to control and aggregate data and revenue from generation and battery storage assets. This fully integrated platform enhances our ability to provide a comprehensive end-to-end service proposition to our established industrial, domestic and energy services customer base.

By integrating energy storage, renewable generation and vehicle charging into the UK energy system, FlexiGrid can help shape consumer demand to follow renewable energy supply and operate as a VPP. This fully integrated platform enhances our ability to provide a comprehensive end-to-end service proposition to our established industrial, domestic and energy services customer base and will address the market disruption affecting the UK and global energy system. Crucially, it provides the technology platform to support the deployment of these new infrastructure CaRe asset classes.

We continue to fully integrate the Solo Energy platform with our wider energy services and leverage our well-established energy services foundations to remain at the centre of the energy system as we transition to a more sustainable and low-carbon economy.

TIM MORTLOCK
Chief Operating Officer
17 March 2020



Stable underlying performance

In the face of industry challenges with the smart meter rollout, we still delivered financial results in line with market expectations.

Given the challenges we have faced during 2019, primarily driven by the continued industry-wide issues and delays surrounding the smart meter rollout, I am very pleased to be able to present a set of financial results that are in line with market expectations.

Whilst our statutory profit from operations indicates modest growth, the continued significant investment in our portfolio of revenue-generating assets is driving a 20% increase in our key performance measure, ILARR, to £90.1m. Our underlying performance, as measured by pre-exceptional EBITDA, has increased by 14% against a backdrop of the volatility of the smart meter rollout and lower installation volumes, highlighting the strength of our underlying business model in investing in assets that generate recurring revenue.

We fundamentally manage the business on a long-term basis, in line with our strategic priorities, and focus on delivering secure returns for our shareholders. We exit the year comfortable with our results and performance.

Well placed for the next phase of our growth and development, the conditional disposal of a minority of our meter asset portfolio on 12 March 2020 realises significant value for the Group and there is a fundamental positive impact on our future strategy, as discussed further within this report.

Revenue

	31 December 2019 £m	31 December 2018 £m	Percentage change
Asset management	82.9	65.5	27%
Asset installation	22.4	26.6	(16%)
Energy management	9.0	6.5	39%
Group revenue	114.3	98.5	16%

Total ILARR increased by 20% to £90.1m as at 31 December 2019 compared to 31 December 2018, in line with our expectations. Consistent with the prior year, most of the growth was seen in the electricity meter division, with an increase in ILARR to £28.1m at 31 December 2019 (31 December 2018: £20.3m). The installation of dual fuel meters as part of the smart meter rollout favours higher growth in our younger electricity portfolio, when compared with our historical gas-weighted portfolio.

The overall growth in ILARR reflects the flow through impact of new contract wins from 2018 and the first quarter of 2019, and growth in the meter estate, together with the combined effect of increases in RPI and rental rates for deemed non-contracted customers. We continue to actively engage with both existing and potential customers in securing our future order book.

Group revenue rose 16%, driven primarily by continued growth in the asset management and energy management divisions, offset by a decline in asset installation revenues. Whilst installation run rates were slower than anticipated through the year, for us and the wider market, our domestic smart meter portfolio has still increased, generating additional revenue.

Together with a favourable increase in the RPI in April 2019, and a pricing increase on deemed non-contracted customers, revenue has increased by 27% in the asset management division to £82.9m (2018: £65.5m).

Revenue continued

Energy management revenue has increased 39% to £9.0m (2018: £6.5m), which continues to be attributable to the capital projects in progress for a large hotel chain. Over 190 sites were completed in 2019 as part of the ongoing energy-efficient lighting project and, towards the end of the year, we embarked on a second significant project for the same hotel chain, delivering smart heating controls.

Asset installation revenue was £22.4m (2018: £26.6m) reducing largely due to legacy installation-only work for third parties coming to an end in the first half of the year, in line with the Group's decision to reallocate internal engineering resource to fit the SMS portfolio of smart meters. The decline in installation revenue has been partially offset by higher volumes of emergency and transactional work on SMS's portfolio of traditional meters, which have required direct replacement whilst energy suppliers become SMETS2 ready.

Gross margins

Overall, the depreciation-adjusted gross margin at a Group level remained broadly consistent at 64% (2018: 63%). SMS includes depreciation on revenue-generating assets within cost of sales and removing this from the margin analysis provides a better comparison of underlying trading performance year on year.

Whilst the Group has experienced a higher than expected proportion of installation costs that are unable to be capitalised, revenues from transactional work have also been higher than expected, providing an offset that has kept the overall depreciation-adjusted gross margin steady.

The depreciation-adjusted gross margin for asset management has also remained steady at 93% (2018: 92%), reflecting the growth in the underlying asset base. The gross margin, including depreciation, has decreased by 6% from 61% to 55%, primarily as a result of a change to a depreciation related accounting estimate, made with effect from 1 January 2019, in relation to SMS's traditional meter assets. As a result, there is an additional £7.3m recognised within depreciation in cost of sales on a statutory basis – see note 1(a) to the financial statements for further details.

The asset installation business reported a negative gross profit margin of 25% (2018: positive 23%). This primarily reflects the Group-wide strategy to focus its internal resources on the smart meter rollout, with legacy external installation contracts coming to an end at the beginning of the year, reducing external revenues and removing the contribution to profitability seen in prior years.

Through the first half of 2019 there was continued investment made in retaining the Group's installation capacity to ensure the business was appropriately positioned to benefit from the run rates initially anticipated from progression to the main SMETS2 phase of the smart meter rollout. Gross profit margin for the asset installation business saw a significant reduction as a result to negative 48% in H1. As initial installation targets in the market started to look increasingly challenging, attention was turned to controlling our operating cost base in order to increase efficiency in the labour force. As a result, the gross profit margin improved to negative 6% in H2. Cost control will be a key focus through 2020 and beyond. It remains key that our overall capacity is right sized in order to meet customer demand efficiently. The full year reported gross margin for the asset installation business, whilst negative, thus reflects management's cost control in the latter part of the year.

The energy management gross margin has increased to 24% (2018: 21%), supported by the commencement of a smart heating controls project at slightly higher margins.

EBITDA

Pre-exceptional EBITDA increased to £58.9m (2018: £51.6m) with statutory EBITDA increasing to £50.4m (2018: £35.5m). This demonstrates that, whilst costs have been incurred to create capacity to support future growth, our increase in revenue has been high enough to offset this.

The Group's tactical retention of its internal engineering workforce, the successful setting up of a dedicated contact centre to help drive the business through the smart meter rollout and ongoing development of key IT platforms that underpin the end-to-end service offering, have increased cost of sales and general overheads in 2019 as a result.

Other costs in the year which impacted our underlying profitability include a £0.8m bad debt write off in relation to smaller independent energy suppliers that have ceased trading and been transferred to much larger energy suppliers under the SoLR mechanism. The last two years have seen a large number of independent energy suppliers enter administration, as a result of a failure to settle their financial obligations with Ofgem. This trend is not anticipated to continue to the same extent into 2020 and beyond. We have also incurred £3.8m of bad debt expense arising from individually impaired trade receivable balances with specific customers.

Despite these additional costs, pre-exceptional EBITDA continued to grow as a result of the strength of our index-linked, recurring revenue base.

Statutory EBITDA has increased, due to a flow through of the above points together with lower overall operating exceptional costs of £8.5m, as compared with £16.1m in the prior year. These are detailed further below.

Exceptional items

The operating charge to the income statement in respect of exceptional items of £8.5m continues to be largely driven by net losses on our meter portfolio of £6.0m, arising from the removal of traditional meters and a proportion of SMETS1 compliant smart meters.

Technical communication issues for some SMETS1 meters on supplier churn have continued through 2019, with the enrolment and adoption process into the DCC delayed into 2020. As a result, the Group has continued to see a very small proportion of SMETS1 meters removed from the wall. As these removals are attributable to the temporary industry transition period, management has taken the judgement to recognise losses arising on the disposal of these meters as exceptional.

In the prior year, we incurred an exceptional charge of £5.6m in relation to the impairment of the traditional meter portfolio, reflecting a higher volume of removals than anticipated and a reduction in future rental income from the reducing portfolio of meters remaining on the wall. There was no similar impairment charge in 2019.

Of the remaining exceptional cost, £2.0m relates to legal and professional costs incurred in the reported sale process of a minority of the Group's meter assets, detailed further on page 32.

Operational and pre-tax profits

Depreciation costs on general property, plant and equipment, excluding meter assets, have increased by £2.2m to £3.6m (2018: £1.4m). This is largely driven by the decision to purchase the Group's fleet of vans, previously leased on an operating basis. £0.9m of additional depreciation has also been recognised as a result of the implementation of IFRS 16; see note 29 to the financial statements for details.

The BEIS consultation, that proposed a new monitoring framework for the smart meter rollout through to 31 December 2024, was still outstanding at the balance sheet date and, therefore, no change to the useful economic life of the traditional meter portfolio has been made in 2019. Upon ratification of the consultation in 2020, management intends to revise the useful economic life through to 31 December 2024 to align with the market. This will be applied prospectively and will see the annual depreciation charge on the traditional meter portfolio decrease.

The net interest charge is £8.3m (2018: £5.7m), reflecting higher average net debt as a result of the continued investment in assets.

Underlying profit before taxation has decreased by 38% to £15.6m. The Group's overall depreciation charge, largely driven by the meter portfolio, and our largest non-cash cost item, has grown from £21.8m to £35.1m. Together with a flow through of the above points, this has resulted in a drop at the pre-tax level. Management is optimistic that pre-tax profits will start to show an upwards trajectory as the smart meter rollout picks up pace and, in the meantime, uses ILARR, revenue and pre-exceptional EBITDA as the key performance measures of the business.

Taxation

The effective tax rate on statutory profits was 26.81% (2018: 16.6%). The increase in the effective rate is driven primarily by an increase in permanent differences from disallowable items, including legal and professional costs incurred in the sale process of a minority of the Group's meter assets.

The Group's capital expenditure as it pertains to meter assets qualifies for capital allowances, providing the Group with tax relief on such expenditure. These allowances are claimed in the tax year in which the asset is acquired and set against taxable profit for that year, thus reducing the total tax payable. As a result, the Group was not tax paying in either the current or prior year.

The Group's deferred tax balance of £13.8m is primarily made up of £11.7m in respect of accelerated capital allowances.

Earnings per share (EPS)

Underlying basic EPS, which excludes exceptional costs, amortisation of intangibles and their associated tax effect is 11.30p (2018: 18.46p), reflecting the underlying profitability of the Group. Statutory earnings per share decreased to 3.56p (2018: 3.97p) as a result of lower statutory profits for the reasons detailed above.

Diluted EPS does not vary significantly from basic EPS; a small decrease is seen as a result of the dilutive impact of shares issuable in the future to settle the Group's share scheme obligations.

Dividend

With regard to the 2019 dividend, the Board has continued to pursue a progressive dividend policy, aiming to increase the dividend proposed by c.15% on its prior period comparative.

The Directors recommend a second interim dividend of 4.58p per share and no final dividend (2018: no second interim dividend, final dividend of 3.98p), bringing the total dividend payable in respect of the year to 6.88p per share (2018: 5.98p), an increase of 15%.

The second interim dividend is expected to total c.£5.2m and will be paid on 4 June 2020 to shareholders on the register at 24 April 2020, with an ex-dividend date of 23 April 2020.

Cash flow

The Group generated an operating cash inflow of £42.4m (2018: £40.0m), supported by underlying revenues and good cash collection.

There has been a significant increase in inventory, with the strategic purchasing of SMETS2 meters to ensure SMS can meet forecast installations in the first part of 2020.

Capital expenditure on property, plant and equipment was £101.7m (2018: £132.6m), excluding right-of-use asset additions of £4.9m. Of this, £95.2m has been used to purchase revenue-generating assets. This capital expenditure is lower than the prior year as a result of lower than anticipated installation run rates throughout 2019 as well as a lower unit cost for SMETS2 meters compared to SMETS1.

A further £6.9m investment has been made in intangible assets. This includes development of software to support the installation business, together with investment in a Group-wide Enterprise Resource Planning system that will consolidate, integrate and update various support systems.

A £1.0m cash outflow was made for the acquisition of Solo Energy Limited, a blockchain energy flexibility IT platform.

There has been a £97.9m net cash inflow from drawdowns on the loan facility in the year. £9.2m of finance costs have also been paid (2018: £4.8m), including £3.1m of arrangement fees in relation to the new facility.

Financial resources

With further growth anticipated as the UK domestic smart meter rollout continues, SMS has access to sufficient funding to accelerate installation in line with market demand.

On 21 December 2018 a new banking facility was signed, providing the business access to £420m on a fully revolving basis over the next five years. The first drawdown under this new facility was on 3 January 2019, and at that date the Group's obligations under the previous facility were settled.

At 31 December 2019, utilisation of the new facility totalled £269.3m, net of £2.5m arrangement fees which will be amortised over the term of the facility. No principal repayments are required until 2022, providing us with greater flexibility during the current industry transition period.

Net debt was £219.2m at 31 December 2019, £77.2m higher than at 31 December 2018, primarily as a result of increased funds drawn down from the Group's banking facility for the purchase of revenue-generating assets. The Group's available cash and unutilised element of the revolving credit facility stood at £200.8m (2018: £278.0m). The Group had cash in bank of £50.1m at 31 December 2019 (31 December 2018: £30.0m).

Disposal of a minority of the Group's I&C portfolio (the "Disposal")

In respect of the 2019 financial statements, this transaction represents a non-adjusting post-balance sheet event, disclosed further in note 28 to the financial statements. It was deemed that the transaction at 31 December 2019 was not highly probable and, therefore, it did not meet the Held for Sale criteria under IFRS 5 at this date. The effect of the Disposal will be accounted for in our financial statements for the year ended 31 December 2020.

The Disposal, generating gross proceeds of £291m, fully resets the Group's leverage, resulting in a positive net cash position versus net debt to pre-exceptional EBITDA of 3.7x at 31 December 2019. Forming the core of our strategy going forward, the size of proceeds received for the disposed portfolio of c.187,000 I&C meter assets reinforces the inherent value present within our meter assets, with their index-linked long-term cash flows and limited maintenance requirements.

Following the deduction of transaction and other expenses, and subject to completion, the Group expects to receive net cash consideration of £282m which, together with a revised debt facility, significantly enhances our ability to maximise domestic smart meter opportunities and secure additional ILARR. The Disposal is expected to result in a gain on disposal of £193m, which will be classified as an exceptional item in the Group's financial statements.

It is intended that the proceeds from the Disposal will be used, in part, to settle our existing loan facility and an amended £300m revolving credit facility will be established on the same terms. This provides significant headroom to manage the business going forward on a low leveraged basis and the Group will have several funding options, providing flexibility to maximise growth in a capital efficient way.

The Disposal also enables us to announce an intended new enhanced dividend strategy of 25p per share, increasing at least with RPI through to 2024. This revised dividend policy seeks to provide SMS shareholders with a long-term and secure dividend pay-out, underpinned by the Group's highly sustainable, annuity-style cash flows.

A key feature of the Disposal is that we will continue to manage the portfolio of disposed assets for the new owners, generating annual RPI-linked recurring management fees of £0.8m for these services. We will still apply our knowledge and expertise in relation to managing the portfolio as we do for other third-party meter owners.

Reconciliation of reported to underlying results

SMS uses alternative performance measures, defined at the end of the Financial Review, to present a clear view of what the Group considers to be the results of its underlying, sustainable business operations. By excluding certain items, this enables consistent year-on-year comparisons and aids with a better understanding of our business performance.

Definitions of alternative performance measures

Alternative performance measure	Definition
Index-linked annualised recurring revenue	The revenue being generated from meter rental and data contracts at a point in time. Includes revenue from third-party managed meters.
Depreciation-adjusted gross profit	Statutory gross profit less depreciation on revenue-generating assets, recognised within cost of sales.
Depreciation-adjusted gross profit margin	Depreciation-adjusted gross profit divided by statutory revenue.
Pre-exceptional EBITDA	Statutory EBITDA excluding exceptional items. ¹
Underlying profit before taxation	Profit before taxation excluding exceptional items and amortisation of intangibles.
Underlying profit after taxation	Profit after taxation excluding exceptional items and amortisation of intangibles and the tax effect of these adjustments.
Underlying basic EPS	Underlying profit after taxation divided by the weighted average number of ordinary shares for the purposes of basic EPS.
Underlying diluted EPS	Underlying profit after taxation divided by the weighted average number of ordinary shares for the purposes of diluted EPS.
Net debt	Total bank loans less cash and cash equivalents. Excludes lease liabilities recognised under IFRS 16.

¹ Exceptional items are those material items of income and expense which, because of the nature or expected infrequency of the events giving rise to them, merit separate presentation on the consolidated income statement.

Reconciliation of reported to underlying results continued

A reconciliation of these performance measures is disclosed below:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m	Percentage change
Annualised recurring revenue	90.1	75.3	20%
Group revenue	114.3	98.5	16%
Statutory profit from operations	13.8	11.1	
Amortisation of intangibles	1.5	2.6	
Depreciation	35.1	21.8	
Statutory EBITDA	50.4	35.5	42%
Exceptional items (EBITDA related)	8.5	16.1	
Pre-exceptional EBITDA	58.9	51.6	14%
Net interest (excl. exceptional)	(8.2)	(4.7)	
Depreciation	(35.1)	(21.8)	
Underlying profit before taxation	15.6	25.1	(38%)
Exceptional items (EBITDA)	(8.5)	(16.1)	
Exceptional items (interest)	(0.1)	(1.0)	
Amortisation of intangibles	(1.5)	(2.6)	
Statutory profit before taxation	5.5	5.4	2%
Taxation	(1.5)	(0.9)	
Statutory profit after taxation	4.0	4.5	(11%)
Amortisation of intangibles	1.5	2.6	
Exceptional items (EBITDA and interest)	8.6	17.1	
Tax effect of adjustments	(1.4)	(3.4)	
Underlying profit after taxation	12.7	20.8	(39%)
Weighted average number of ordinary shares (basic)	112,446,154	112,408,338	
Underlying basic EPS (pence)	11.30	18.46	
Weighted average number of ordinary shares (diluted)	113,269,412	113,465,235	
Underlying diluted EPS (pence)	11.22	18.29	

DAVID THOMPSON
Chief Financial Officer
17 March 2020

Sustainability

In recent years, there has been a notable increase in the significance of sustainability for both the business community and society more widely. As a major energy services company, we are particularly sensitive to the environmental climate in which we operate and the impact we have, both through our customers and in building our own sustainable energy infrastructure. We are passionate about using our capabilities and resources to make a positive impact and the development of our people is a critical component of this. For us, being sustainable also means being safe, secure and reliable. Our commitment to health and safety underpins all our business practices, ensuring that our employees and customers are protected. Below, we share more details on these key focus areas: the environment, our people and health and safety, highlighting our developments throughout 2019 and future priorities as the UK's energy system continues its transformation.

The environment



Introduction to our net positive effect

The scale and urgency of global action required for climate change to be halted and reversed has come to the forefront in 2019. Our business is intrinsically linked with tackling one of the greatest challenges of our time, and we are proud to be utilising our passion and innovation to work with the global community as part of the solution. Our commitment is evident in our vision to be at the heart of the smart energy low-carbon revolution and we have built our services around transforming and decarbonising the UK energy system.

We fulfil this vision through our unique energy offering, serving energy suppliers, the industrial and commercial sector, and the wider Domestic market to realise both the environmental and financial benefits of smarter energy practice.

We have been recognised for this through the London Stock Exchange's "Green Economy Mark", awarded to organisations that generate over 50% of total annual revenues from products and services that contribute to the global green economy.

In 2019, we developed a holistic view of our Company sustainability, quantifying both our positive impacts through our services and our negative impacts from our business estate and fleet, to attain an overarching understanding of our total sustainability.

We use this "net positive" perspective to align business growth, financial benefits and sustainability gains, investing in the development of our carbon reduction services, including support of the UK smart meter rollout and delivery of energy efficiency projects.

We look to grow the positive impact of our services (handprint) in comparison to our negative impact (footprint). In 2019, the positive services we were able to provide significantly surpassed the footprint we left behind. Our handprint was over nine times larger than our footprint.

2019 highlights – summary of net positive figures

Our 2019 business footprint: 3,120 tonnes of carbon produced

2,880 tonnes of carbon produced from our fleet

240 tonnes of carbon produced from our estate

Our footprint is the carbon produced by our operational activities; our current scope looks at the energy consumed by our fleet vehicle and across our sites.

Our 2019 business handprint: 26,987 tonnes of carbon mitigated

22,484 tonnes

of carbon mitigated from smart meters

4,502 tonnes

of carbon mitigated from energy efficiency projects

Our handprint is the carbon mitigated through our delivery of services. We currently use data from smart meter energy saving research, and savings data from energy saving projects delivered, to calculate our total handprint. Our current handprint is the equivalent of 33,410 UK households powered by clean electricity.

Handprint vs Footprint

Handprint was nine times larger than footprint

(2018: handprint was eight times larger than footprint)

Recognition

Fleet of the Year finalist

Energy Saving Trust

Energy Efficiency Project of the Year

BusinessGreen

Green Economy Mark

London Stock Exchange

Renewable electricity purchased

73%

Reduction in energy consumption per vehicle

22%

Vehicles upgraded

37%

2019 operational energy consumption

13,038 MWh

Our operational footprint is the energy we use across our fleet and estate. As our business grows, we are developing our ability to de-couple operational growth and energy consumption.



The environment continued



Source: UN Sustainable Development Goals

Our net positive effect in context

Climate change remains an issue that will require action from all areas of government, business and the wider human population. We support global action through our key services, which directly serve Sustainable Development Goal 7: Affordable and Clean Energy, Goal 9: Industry, Innovation and Infrastructure and Goal 12: Responsible Consumption and Production.

At SMS we have worked to help customers lead this global sustainability revolution, providing leading-edge services and products to help them quantify impacts, track energy usage and, critically, work together to halt climate change through lowering their carbon footprint.

During 2019, we were invited to several global research and learning initiatives, lending our voice and expertise to both the global and local community.

We use our knowledge and experience to develop and deliver services which will drive efficiency increases and open opportunities for renewable sources across all four highest UK emissions sectors.

Delivering net positive sustainability through our products and services

In 2019 we focused our innovation and investment on expanding the services which deliver the future of low carbon, helping customers reduce their carbon footprint and increase their efficiency.

Acquisition of Solo Energy

The acquisition of Solo Energy advances our offering, with the development of a Virtual Power Plant (VPP), which will help us support our customers in moving towards decentralised, 100% renewable energy storage.



Innovation in sustainable services

During 2019, our innovation team doubled in size, increasing the speed and breadth of capability to deliver the team's key objective: explore, evaluate and develop new propositions in line with the Group's wider strategy of asset ownership, generating recurring sustainable revenue. The team's expertise centres around linking renewable generation, storage and optimisation strategies, providing the missing link for customers to embrace smarter, greener energy.



Projects delivered

Lighting

We have continued to work with a key customer in the hospitality sector, delivering risk-free investment in a LED sensor lighting project, utilising advanced energy monitoring to clearly demonstrate energy reductions at every phase and location. Through a combination of infrastructure and engineering design, customer utilisation data, and our knowledge of energy efficiency, we ensured the best possible solution for time, cost and quality in excess of building standards. A key element of the project was designing a bespoke set of lighting and control principles which enable scaled rollout across the organisation's 460 sites. This project was recognised by BusinessGreen in the 2019 Leaders Awards, as a finalist for Energy Efficiency Project of the Year.



Heating

We have developed our knowledge of large-scale energy efficiency upgrades and launched an exciting new project, delivering smart control of heating at scale to realise savings in the hospitality environment. Our low-cost connectivity system enables monitoring and control of heating, ventilation and air conditioning (HVAC) through retrofitted wireless controllers and a web-based portal. This combination offers an alternative to expensive Building Management Systems (BMS), whilst accurately monitoring activity and triggering performance parameter alarms, delivering customer comfort and energy savings.



Living our values and reducing our footprint

Sustainability governance

Our culture and principles are driven from the top and the passion of our leadership team is evident in the policies they set through to their everyday actions. This ethos is translated into our business values, policies, processes and management systems to ensure a consistent, integrated business-wide approach to sustainability.

Management systems

We implemented our Energy Management System (EnMS) across SMS in 2019, achieving external certification in ISO 50001 in November. Our EnMS works by providing a framework of policy, procedure, monitoring and targets which enable us to identify and realise energy efficiency improvements across our organisation. We also retained certification for our Environmental Management System (EMS), held by our Cardiff sites for eight years, adding our Glasgow office to the existing certification in early 2019.

Installer fleet

Our fleet of engineer vans is critical to providing smart meter upgrades to customers across the country. As our most significant source of emissions at SMS, we have a dedicated team supporting driver training and the monitoring and upgrading of our fleet vehicles.

During 2019 we intensified efforts on our fleet efficiency. We upgraded 37% of our fleet vehicles, increased our consumption audits, refreshed our driver handbook and continued our driving behaviour training, achieving a reduction in energy per vehicle of 22%.

The fleet has grown to support our increasing demand for installations; this increase has enabled a greater geographical coverage of installers working more locally. Alongside evolution of our current fleet, we are looking at step-changes through the trial of EV alternatives, which have been added to our van and pool car fleet. The dedicated work of the fleet team was recognised by the Energy Saving Trust, which nominated SMS for the Fleet of the Year award, in which we became a finalist in November.

Meter refurbishment

For every retrofitted smart meter, our engineers take back the old meter to our logistic hubs. From there these are sorted between those owned by SMS or other companies. Meters owned by other companies are returned, whilst SMS meters are handed on to our specialist team. This team is trained to assess the condition of the meter and refurbish ready for potential reuse. Not only does this avoid waste but it supports the circular economy, ensuring these meters retain their material value and purpose even after they have been used.

Purchased renewables

Our purchased renewable electricity is secured through our electricity provider, ensuring the energy we consume is matched by renewable energy production through the "Renewable Energy Guarantee of Origin" (REGO) certification scheme. We have worked hard to consolidate and move our electricity contracts to renewable sources and 73% of our estate consumption is now derived from renewable sources. All remaining sites are due to be transferred in early 2020.

Estate refurbishments

In 2019 we successfully met our objective to improve environmental comfort, aesthetics and building energy performance in our older building stock and incoming estate. Five key sites received refurbishments in 2019, varying from upgrades of HVAC systems and LEDs to full office strip-outs.

2020 and beyond

We have ambitions to grow our handprint significantly over the coming year, continuing to deliver smart meter technology whilst working within our sector to deliver the new technology, services and projects needed to realise the UK's net-zero carbon target by 2050.

We will also be working to reduce our footprint through increased scrutiny of our consumption data and identification of opportunities. We will continue the alignment of business service and operational activity, leveraging beneficial synergies between our business offering and our internal operations.

The next few years will see intense evolution across the energy production and consumption landscape, and SMS will play an important part in the transformation to a more sustainable world.

Engaging our people

Energy facility co-ordinators

We have used our management systems as a vehicle to establish a network of facility co-ordinators across the main SMS sites. These individuals act as both points of contact and ambassadors for our energy efficiency initiatives, meeting on a quarterly basis to share performance, successes, challenges and best practice.

Staff training

In 2019 we have renewed our corporate Company induction, which now includes messages from Directors on the importance of environmental sustainability and a dedicated sustainability section ensuring that the sustainability culture of the business is instilled in all employees from the moment they join the Company. This new induction format has been shared across existing and new staff alike, with over 85 new employees onboarded under the enhanced corporate induction programme.

Stewardship, community and charity

Throughout 2019 our established social committees and dedicated employees have delivered exciting events across various sites, working with local education institutions and within the community.

We provide work experience placements and are part of the "Career Ready" programme. Within our communities, we have focused on promoting biodiversity, with employee groups assisting with litter picking initiatives and working with local park rangers in maintaining and conserving green areas.

We have supported a range of charities in 2019 and promoted several awareness events including Mental Health and Stress Awareness during World Mental Health Day, National Stress Awareness Day, Movember, Save the Children, Macmillan Coffee Mornings, Food bank and many more.

Our people

Employee engagement

SMS's people strategy is "to enable a high performance, reward and engagement culture" with a core focus on employee wellbeing. We look at our business not purely in terms of financial success but for the benefit of all our stakeholders, including employees, the community and shareholders. In this way we can more effectively deliver our long-term objectives.

A designated Non-executive Director has ultimate responsibility for engaging with the workforce in a more structured way, supported by the Group HR Director, to ensure that the importance of and plans for culture, reward and the employee voice are highlighted. We have undertaken various projects throughout 2019 which have helped to support and embed this.

Values and behaviours

As SMS continues to evolve, we felt 2019 was the right time to redefine our values, build on our culture and reinforce behaviours to ensure they reflect the strategic positioning of the business and our future focus. Our people are passionate about our values and behaviours and we wanted to involve them on our journey and provide them with something they could embrace wholeheartedly. We have held over 30 one-hour workshops across all our sites to capture our people's thoughts as to what they felt our values and behaviours should be. Feedback was collated and reviewed,

and, in June 2019, we successfully launched our five new core values: Safety, Innovation, Customer Excellence, Sustainability and Pride. These were subsequently embedded into our employee journey including recruitment, policies, procedures and performance management.

Our five core values capture who we are, what we believe in and what we stand for. These are applicable to all employees and through the involvement of our employees we have also developed behaviours directly linked to our five core values and our commitment to "Putting Our People First".

A shared understanding of what is expected and what is acceptable to others, and consistency of approach from all employees, is essential. The behaviours of all our employees support the delivery of our mission, vision, values and culture.

To live our values, SMS is committed to providing an environment and experience which reflects them. All employees are responsible for their own behaviour and are expected to display SMS's values and behaviours throughout the working day and when representing the Company. They are embedded into daily working lives, to ensure that SMS is a great and safe place to work, where people are kind to each other and both internal and external customers are treated with equal importance. Refer to pages 42 to 43 for further details on our commitment to health and safety.

To live its values, SMS is committed to providing an environment and experience which reflects them.

Our culture is assessed through compliance reviews, internal audit and formal and informal employee channels and is measured by engagement, health and wellbeing and diversity indicators.

What are SMS plc's values and behaviours?



Temperature check sessions

To sustain our high level of staff engagement culture, we introduced regular temperature check sessions and engineer stand-down days to encourage the involvement of our people to share best practice, ideas or concerns, and have these answered, whilst ensuring open communication. Checking how our people are feeling and gathering suggestions for improvements is crucial.

In addition, we also use our intranet as a source of news and information, employee newsletters, briefings by the Executive team and face-to-face meetings, to keep our employees informed of matters affecting them and the performance of the business. A new benefit following employee feedback was the introduction of 25 days' holiday plus eight bank holidays for all our full-time employees (pro rata for part time) and an additional five days of annual leave once five years' service has been achieved.

Talent management and development

We recognise our people play a crucial role in delivering business success and to facilitate this, we support and encourage continuous professional development.



What our employees have said about us

"I get good support from the senior leadership team here and we are working together towards the end goal of achieving a diploma in advanced warehousing and storage. I am really grateful that the Company has backed me and my development."

RYAN BRUCE
Transport Team Leader

In 2019, we continued our focus on providing our people with further opportunities to develop and utilise their skills more fully to better achieve their potential and increase business performance. This included additional eLearning modules, personal development reviews and learning plans, 14 new training courses, and the introduction of a broader array of apprenticeship qualifications such as Chartered Management Institute programmes, warehousing and storage, and project management. By investing in our people, we are demonstrating our commitment to "Putting Our People First", achieving long-term sustainable growth, and increasing organisational effectiveness.

We volunteered to participate in a mentoring programme with "Career Ready" which offers mentees advice and support during the academic school year, and a four-week paid internship during the summer break. This provides a further pipeline for talent, together with supporting our corporate social responsibility ethos.

The SMS training academy is a centre of excellence and is fully accredited under the Accredited Certification Scheme (ACS); the industry recognised and accepted route for new and experienced gas operatives to gain the training and certificate of competence needed to become a member of the Gas Safe Register. We are a National Skills Academy for Power; are certificated and accredited for all domestic metering and gas appliance installation, servicing and maintenance functions; and are certified for I&C gas metering installations, testing and maintenance. The academy delivers technical gas and electricity training and induction programmes, traineeships and apprenticeships, including appliance testing and certification for engineers and electrical metering and appliance testing and certification. Currently under development are EV charging installation courses and GIRS design and utilities training packages for connections – solar, battery storage and PV.

October saw the launch of our new interactive corporate induction programme, which involves participation in videos from current employees, and has been delivered to 85 employees to date. The induction places a strong emphasis on our culture, new values and behaviours, provides consistency of approach and includes helpful mandatory training elements to set our people on the path to success.

Health and wellbeing

Recently, we have focused on raising awareness of mental health issues which was supported by the delivery of mental health awareness training via Mind to 96 members of our management team. In 2020 we will look to expand this further, by delivering training to successfully introduce Psychological First Aiders at each of our sites to assist our people with their health and wellbeing.

Other initiatives to encourage wellbeing and support inclusiveness include dedicated occupational health support and an Employee Assistance Programme that offers confidential and free counselling. We are also delighted to be part of the Tommy's Pregnancy at Work Accredited Scheme which provides our employees access to a free pregnancy advice line operated by midwives, helpful digital pregnancy advice guides and access to an online members' community featuring the latest legal information and further support for managers and employees.

What our employees have said about us

“I was employed by SMS in June 2010 as an I&C Electric Field Engineer. After three years I was asked to assist with the audit programme of a service provider and, from this role, a position became available for a Field Metering Manager. During my time within this role I have attended several courses to help further my career with SMS; some of these courses included IOSH accreditation, mental awareness and financial principles, etc. Recently I have been appointed to Head of Engineering Delivery for SMS and I have been selected to complete a level 4 ILM leadership and management apprenticeship to assist with my development for this new challenge.

SMS continues to support my development requirements which enables me to progress with my career whilst learning at the same time.”

CHRIS PITT

Head of Engineering Delivery



Our people continued

Diversity and human rights

We aim to create a positive, diverse and inclusive working environment that attracts, develops and retains our people. The Group operates an equal opportunities, diversity and inclusion policy, which is documented in its employee handbook and made available to employees through the intranet. This aims to ensure that all employees, potential employees and other individuals are treated fairly and equally regardless of their age, disability, gender reassignment, race, religion or belief, sex, sexual orientation, marriage or civil partnership and pregnancy or maternity.

We became members of the Employers Network for Equality & Inclusion, and we will continue to drive continuous improvement with regard to equality, diversity and inclusion in our culture. We are building the foundations to support business growth and sustainability and we reinforce our values and associated behaviours with every interaction we make. Our people understand what our brand stands for because it is an integral part of our employee journey.

Our new eLearning course, “Equality, Diversity and Inclusion”, was rolled out to all of our employees to increase understanding and awareness of other cultures, and support learning of appropriate action and behaviours.

We expect our people to live our values and treat each other with kindness and respect. All employees are responsible for their own behaviour and are expected to display our values. Our key policies which recognise, support and protect our employees’ human rights include:

- ▶ modern slavery and human trafficking;
- ▶ anti-bribery and corruption;
- ▶ whistleblowing, which includes the provision of a confidential telephone service operated by an external provider to ensure there is no bias;
- ▶ equal opportunities, diversity and inclusion;
- ▶ discipline;
- ▶ grievance; and
- ▶ dignity at work.

Our anti-bribery and corruption policy includes guidance to employees on the giving, receiving and recording of business gifts and hospitality, together with other areas of specific risk, and is reviewed annually to ensure it remains fit for purpose. Any breaches of policy are investigated and reported to the Audit Committee. During the year, there were no cases of reported bribery or corruption.

Gender pay gap reporting

SMS supports and encourages a culture of gender diversity amongst its workforce. It is the contributions of our people from all backgrounds that ensure we are successful, as only innovative thinking will produce the solutions we need to tackle the varying challenges faced by our business. Industry-leading thinking will diversify and transition the energy market and therefore SMS welcomes and supports gender pay gap reporting (introduced to increase pay transparency) and is committed to equal opportunities, diversity and inclusion throughout the business.

Being part of the historically male-dominated engineering industry, it is no surprise that SMS has such a wide gender split between men and women, and that a gender pay gap exists. Overall, SMS has a 31% female and 69% male workforce.

The mean gender pay gap for the consolidated Group is 28.8% and the median gender pay gap is 33.4%. The rationale specifically within SMS includes:

- ▶ there are more men than women within the engineering industry, from which we source most of our employees;
- ▶ there are more men than women in senior roles;
- ▶ there are more woman in part-time roles; and
- ▶ there are more women in lower paying roles.

These issues are, however, prevalent throughout the UK and on a wider global level. They are therefore not limited to SMS, as can be seen via EngineeringUK, which provides workforce statistics. It is clear that: "There is continued gender disparity

in engineering: while women comprised 47.1% of the overall UK workforce in 2018, only 12.0% of workers in engineering occupations were female."

In addition, with regard to the percentage of female Fellows at the Royal Academy of Engineering, women only make up 7.7% of its active Fellowship, which excludes Emeritus, Honorary and International Fellows.

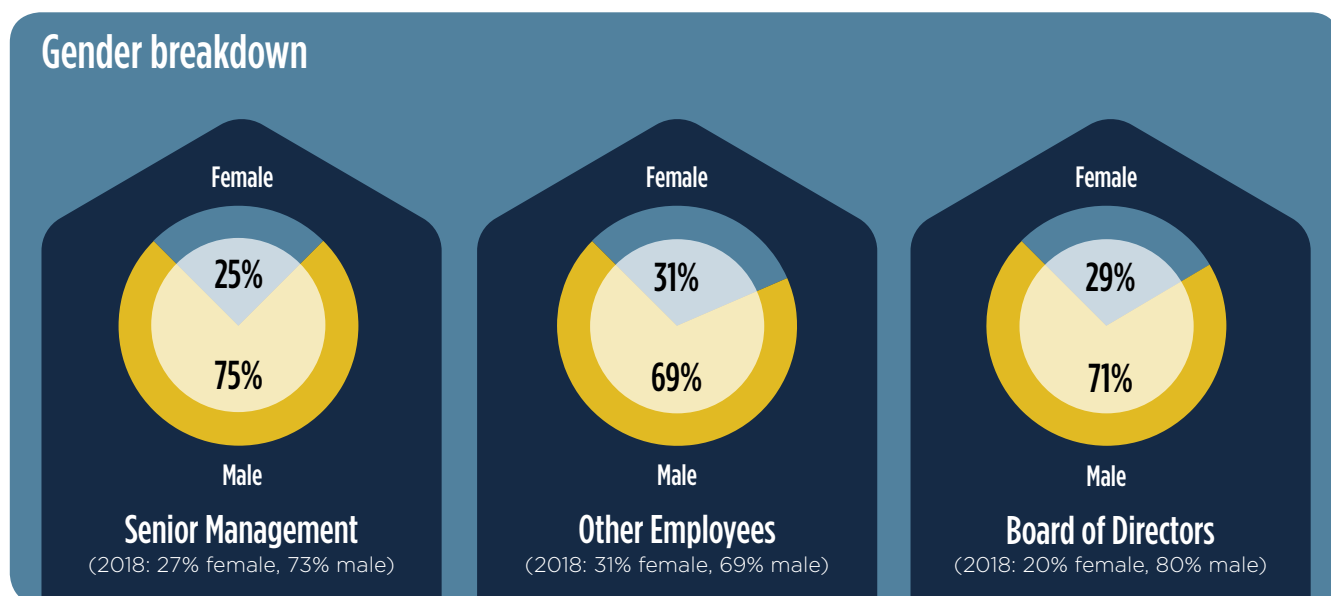
Importantly, SMS has taken positive action in 2019 which includes:

- ▶ the appointment of women to two senior roles including Divisional Finance Director and Group HR Director;
- ▶ the appointment of women to two upper middle management roles of Regional Operations Manager and Business Development Manager; and
- ▶ the internal promotion of three women to middle roles including: Internal Audit Manager, Group Financial Analyst and Senior Financial Accountant.

In addition:

- ▶ we became an "Accredited Living Wage" employer and therefore the salary for our entry level roles has increased;
- ▶ we are also in the process of reviewing our career levels and creating one SMS pay and reward scheme across the business; and
- ▶ we are actively involved in the "Career Ready" mentoring programme, working with young high school students to provide mentoring in their future career and study choices.

Gender breakdown



Accreditations obtained in 2019



Health and safety

We are committed to being a safe, secure and reliable organisation.

Key highlights

- ▶ Executive leadership completed Directors' role in health and safety training course.
- ▶ New Electronic Quality Management System (EQMS) introduced and operational.
- ▶ Mental health awareness training deployed across the business.
- ▶ New Training Academy in Bolton fully operational.
- ▶ Certification for ISO accreditations 9001, 14001, 27001 and OHSAS 18001 maintained.
- ▶ Transition plan from OHSAS 18001 to ISO 45001 on target.
- ▶ Engineering systems platform upgraded for health and safety and audit management.
- ▶ Mandatory SHEQ training ongoing.
- ▶ ISO 50001 Energy Management Systems accreditation achieved.

Introduction

SMS has maintained a dedicated focus on its safety, health, environment and quality (SHEQ) journey through 2019. The year began with a series of mandatory health and safety courses for Directors and senior managers. This set the tone and underpinned executive leadership's commitment to the Company's core values, with safety as the priority.

Our SHEQ training programme is fundamental to the improvements that were targeted in 2018 and the benefits are now being realised with IOSH Managing Safely courses delivered to managers across the country in the year. Increased staff awareness, engagement and ownership of health and safety are evident throughout the business and participation in regional SHEQ forums has ensured that the SHEQ strategy is delivered consistently to all parts of the business.

The 2019 strategy and action plan continued to build on the foundations and experience that SMS has, with over two decades in the sector, and ensures that we are ready for the challenges of the future.

Overall, performance has been positive, with ongoing progress made towards our objectives and targets, and we continue to invest in SHEQ to meet current and future needs.

Occupational health

People Asset Management (PAM) was appointed as the occupational health provider for the Group. Working closely with SHEQ and Human Resources (HR), PAM is providing support nationally for the business' occupational health needs. This includes expert advice on occupational illness and injury and delivery of our drug and alcohol screening programme.

A mental health awareness training package has been developed and deployment commenced in 2019. This will extend through 2020 as we continue to support our employees with any mental health issues they are experiencing whilst raising awareness of the debilitating effects associated with poor mental health.

ISO accreditations

The business maintained all ISO accreditations in 2019 with no major non-conformances recorded during the audit processes.

Certification was awarded for ISO 50001 Energy Management Systems (EnMS) in November. This underlines our sustainability aspirations and we expect further reductions in energy usage in 2020.

The transition plan from OHSAS 18001 to ISO 45001 for the Occupational Health and Safety Standard is on target.

Systems

Our new electronic quality management system (EQMS) is live. EQMS is the cornerstone of our risk management processes and we are already experiencing improved reporting, better action tracking and the centralisation of our SHEQ documentation. The investment in and ongoing development of EQMS will ensure we are in a strong position to meet the needs of Industry 4.0, the Industrial Internet of Things (IIoT) and the Connected Worker. It also takes us a step closer to predictive analytics.

Over the course of the year, we have been working to make improvements to our Field Service Manager (FSM) engineering management platform. These improvements will enable our engineers to record safety related information on job cards and strengthen our auditing capabilities.



Competence

During the year, the business fully established a new Training Academy in Bolton. This increased the depth and breadth of our internal training capability and improved the geographical spread of the business with centres in the east and west of the country.

One of the key features of the facility is the purpose-built street scene where engineers undergo training in an environment that is very similar to what they will encounter whilst in the field. This blend of bespoke practical and classroom-based training ensures that SMS engineers are trained to the highest standards and further emphasises the business' commitment to leading the smart energy revolution.

The training delivered in the academies is further supported in the field via the Company's eLearning platform Nimble. Nimble is a modern and efficient learning environment that allows us to create content specific to the works that we undertake.

The ongoing improvements to our training offering will ensure that our engineers and other staff maintain the proper competencies to flourish in their respective roles.

Accidents and incidents

Our performance over the year remained stable with the accident frequency rate at 0.16 (December 2019). This is encouraging as our engineering workforce increased significantly in 2019. We regret to report four injuries under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013 (RIDDOR); however, none of these were considered significant. The injured parties have all returned to work with no long-term effects expected. The injuries were all related to manual handling and ergonomics and we have looked closely at the root causes and identified a bespoke training package, which is being assessed for suitability. This will reduce the risks from manual handling and ergonomic issues and raise awareness amongst our engineering teams.

Operational road risk continues to be monitored closely. Numerous initiatives are underway to improve driver behaviour including accreditation with the Fleet Transport Association (FTA) and personal driver assessments.

2020 and beyond

The continued growth and diversification of the business means an ever-changing risk profile. The SHEQ team works closely with the Sales and Business Development functions to ensure that we have suitable and sufficient mechanisms in place to manage existing and emerging risks.

Our targets and objectives, for 2020 and beyond, reflect the dynamic nature of the business and specific measures are detailed relating to competencies, training and sustainability as we move further into new territories such as the smart homes sector.

Over the past few years we have invested significantly in SHEQ technology to support the growth and diversification of the business. These systems are now embedded, and they will facilitate the improvements that make up some of our key objectives for 2020 and beyond.

Summary

Health and safety is, and always will be, our number one priority. We are committed to being a safe, secure and reliable organisation and will act diligently to protect our employees' health and safety and others who may be affected by our activities at all times.

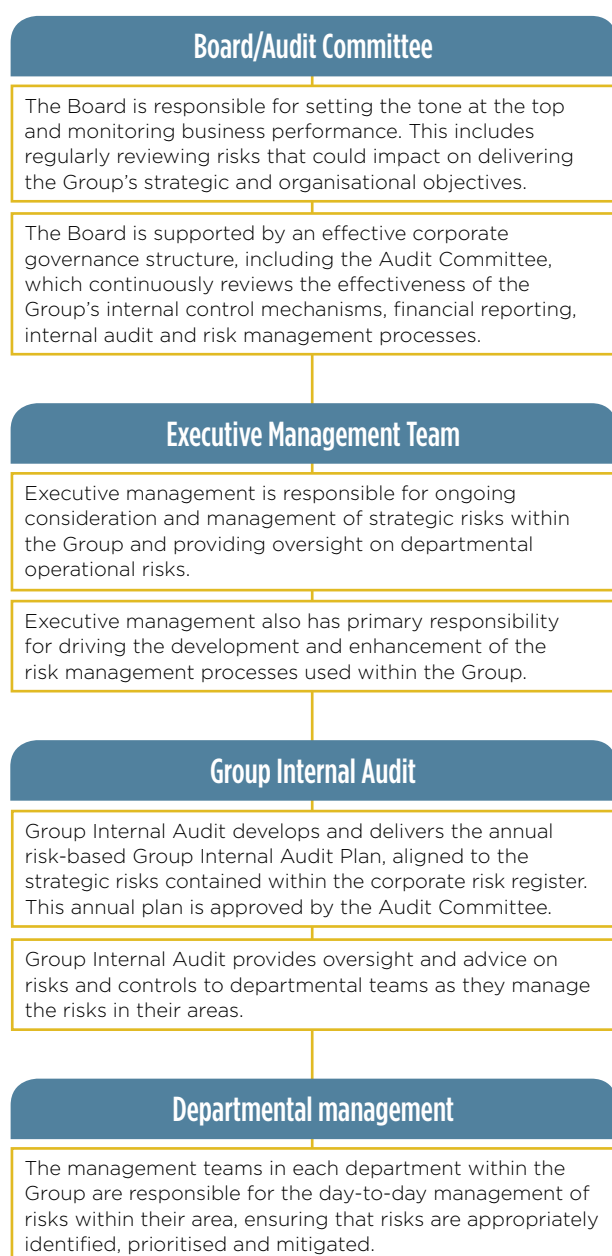
Safety is one of our core values and we will continually strive to improve our performance to meet our aspiration of zero harm across our business.



Risk governance and management

As the SMS business has grown, we have continued to develop and refine our risk management approach. We provide services in a range of potentially high-risk environments and our commitment to effective risk management continues to be a primary focus. The risk management framework shown below highlights the main responsibilities for managing risks within the business.

Risk management framework



The Group Internal Audit team has worked closely with the Audit Committee, Executive Management Team and departmental teams throughout 2019 to support the embedding and continuous improvement of risk management processes and structures within the Group. This work has included facilitation of regular departmental risk update workshops, used to:

- ▶ identify new risks, review and update existing risk ratings;
- ▶ identify appropriate new mitigating actions; and
- ▶ assess progress towards completion of identified mitigating actions.

During 2019, significant progress was made towards readiness for the January 2020 launch of the EQMS quality management system, used for centrally tracking and co-ordinating Group compliance, safety, health and environment, and risk management activities and Group Internal Audit actions. Monitoring and reporting of risk to the Board and Audit Committee have been further developed alongside a number of internal audit reviews into specific risk areas within the business which have assisted risk management in those areas.

Understanding our risks

The organisational risk management framework comprises the recording and management of "top-down" strategic risks, which are discussed by the Board and Executive Management Team, as well as "bottom-up" risks, which capture potential operational issues at a departmental level. Our risk assessment model considers:

- ▶ the probability of a risk crystallising; and
- ▶ the potential impact if the risk crystallised.

These risks have been scored and placed on the risk heat map opposite, which is a matrix of probability and impact and shows our principal risks and uncertainties. Our model considers each risk from two different perspectives:

- ▶ the extent of inherent risk (before any mitigating controls or actions have been designed and implemented); and
- ▶ the extent of residual risk (after mitigating controls and actions have been successfully executed).

The heat map provides a picture of residual (mitigated) risk at the corporate level and allows us to assess the effectiveness of our internal control environment and take further action as appropriate. The matrix also enables the Group to focus the internal audit activity.

We continually evaluate our principal risks in line with our strategic priorities and the prevailing industry and market conditions. In 2019 we have further developed our risk framework, including:

- ▶ moving to an increased frequency of risk update workshops for the corporate risk register and each departmental risk register;
- ▶ enhanced and more detailed reporting to the Board of the significant strategic risks to the Group;

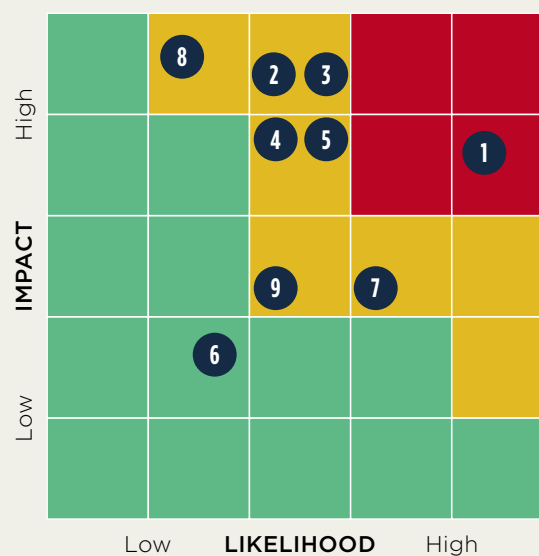
- ▶ consideration of new and emerging significant global and industry risks; and
- ▶ research on best practice in the presentation of risk information.

These processes have driven an updated view of the Group's principal risks and uncertainties in 2019.

Our principal risks

Our principal risks are assigned a red, amber or green status depending on the perceived overall severity. Risks that fall into one of these categories are treated as follows:

	Some action may be required, and risks are routinely monitored by management.
	Action is required to mitigate the risk through improved control with oversight from executive management.
	Mitigating actions are required immediately. Oversight is provided by the Board, Audit Committee and executive management directly.



All risks are assigned mitigating actions with an appropriate business owner and are supported by an executive sponsor to ensure there is a robust process for continuous improvement and accountability at senior management level. The risks captured in the heat map are in line with those identified in the prior year, although the scale of risk has been adapted in some cases as the Group has responded to changes in the environment.

1	Potential breach of cyber security	6	Funding and working capital management
2	Major health and safety incident	7	Brexit
3	Speed of organisational growth (near term)	8	Loss of required accreditations
4	Business continuity – failure of critical business system(s)	9	Potential breach of General Data Protection Regulation (GDPR)
5	Critical supplier dependency		

Coronavirus – an emerging risk

The ongoing spread and development of COVID-19 globally presents a potentially significant risk to the business, with the Group's primary concern being that of the welfare of its people, customers and the end consumer.

With immediate advised protection measures already introduced, the Group is prepared to take further mitigating steps as needed. This includes the potential closure of offices and warehouses, subject to further Government guidance, with most of the workforce able to continue to work and support the Group's customers from home, and consideration over further supporting the maintenance of a gas and electricity supply on an emergency basis for our customers under the right circumstances.

Should closures be required, the Group will ensure that all activities required to support necessary field work, and IT infrastructure that cannot be conducted remotely, can continue to be carried out. These will be supported by increased protection measures to ensure that the health and wellbeing of those field and office-based employees is protected.

The COVID-19 situation is evolving rapidly and the impact on the short-term financial performance of the business cannot be accurately quantified. However, the Group has a robust balance sheet, which will be further strengthened upon completion of the conditional disposal of a minority of the Group's meter assets for total gross cash consideration of £291m. In addition, the Group's high-quality, index-linked recurring revenue streams earned on its existing meter and data asset base should remain unaffected by the outbreak.

Management will continue to monitor developments and is prepared to respond as the situation develops further.

Our principal risks and uncertainties

Set out below are the principal risks and uncertainties which could have a material impact on the Group. The numbers correspond to the risk identified on the heat map. These risks are continually monitored. The degree to which the Board considers that the likelihood or impact of the risks materialising is increasing, decreasing or unchanged is shown and the table also sets out the corresponding mitigating actions that have been taken by the Group.

Risk unchanged ↺

Risk decreased ↴

Risk increased ↲

1 Potential breach of cyber security

FY19 ↺

Detailed risk

Critical information technology systems could be subject to a major external or internal cyber attack, causing a breach of information security regulations and/or service disruption.

Potential impact

- ▶ Financial penalties under information security regulations
- ▶ Financial loss
- ▶ Unauthorised access to systems and data
- ▶ Service disruption
- ▶ Loss of customer and/or supplier confidence
- ▶ Loss of accreditations and certifications

Existing mitigating controls

- ▶ Formal cyber security policy, including phishing response procedure, communicated to all SMS staff
- ▶ Mandatory security awareness training for all SMS staff
- ▶ Physical controls in place including firewalls and encryption
- ▶ A dedicated information security team
- ▶ An independent Board-level Information Technology Committee

2 Major health and safety incident

FY19 ↴

Detailed risk

An incident occurs, leading to significant injury, illness or loss of life to an employee or third party.

Potential impact

- ▶ Injury or loss of life
- ▶ Financial penalties
- ▶ Increased scrutiny from regulatory and oversight bodies

Existing mitigating controls

- ▶ Maintenance of high-quality and mandatory training standards, driven by job roles
- ▶ Rolling internal technical assurance audit programme
- ▶ Mentor-led technical assurance programme
- ▶ ISO accreditations across the Group
- ▶ Independent regulatory reviews

3 Speed of organisational growth (near term)

FY19 ↲

Detailed risk

Speed of organisational growth in the short term without sufficient and appropriate growth in infrastructure.

Potential impact

- ▶ Insufficient engineering capacity/resource available
- ▶ Limitations on organisational back-office and support functions
- ▶ Metering supply and warehousing operations cannot meet demand
- ▶ IT infrastructure does not scale up quickly enough to meet business needs

Existing mitigating controls

- ▶ Robust forecasting processes closely aligned to commercial and operational management teams
- ▶ Well-established supplier onboarding processes
- ▶ Strategic and targeted recruitment activity for engineers
- ▶ Subcontractor call-off arrangements in place across UK
- ▶ IT strategy closely aligned to organisational strategy for growth and future business modelling and includes regular needs assessment

4 Business continuity – failure of critical business system(s)

FY19 ➔

Detailed risk

Failure of core and/or critical information technology systems could result in operational interruption.

Potential impact

- ▶ Temporary loss of critical business systems
- ▶ Loss or corruption of data
- ▶ Detrimental impact on customer service
- ▶ Potential loss of revenue through inability to meet customer orders or issue invoices

Existing mitigating controls

- ▶ Business continuity plan in place across the Group
- ▶ Monitoring of industry data flows and escalation of issues should they arise
- ▶ Disaster recovery plans in place for critical IT systems
- ▶ Failover facility available for immediate redeployment of staff, enabling key operations to be serviced
- ▶ Alternative UK sites available to manage core business operations

5 Critical supplier dependency

FY19 ➔

Detailed risk

The Group relies on a limited number of critical suppliers, including meter manufacturers, and failure of one critical supplier could have significant operational and financial implications.

Potential impact

- ▶ Unable to fulfil customer orders
- ▶ Business continuity issues
- ▶ Legal and financial exposure

Existing mitigating controls

- ▶ Growth in the Group's supplier base continues to mitigate the risk of over-reliance on critical suppliers
- ▶ Business continuity arrangements in place
- ▶ Centralised legal function protects commercial interests through robust contracting process
- ▶ Enhanced stock control processes mitigate the risk of being unable to fulfil customer orders upon failure of a critical supplier

6 Funding and working capital management

FY19 ➔

Detailed risk

Suitable funding arrangements are critical to enable the continued growth of our asset portfolio. Poor management of core elements of working capital, particularly during peak activity periods, could lead to inability to meet creditor requirements and financial impact.

Potential impact

- ▶ Default on debt obligations
- ▶ Credit or debt facilities are withdrawn
- ▶ Inability to meet existing customer or trade commitments
- ▶ Increased supply chain costs

Existing mitigating controls

- ▶ Credit control facility and robust commercial billing arrangements
- ▶ Regular and formal review of key management information in relation to cash and debt positions
- ▶ Asset portfolio sale in March 2020 resets leverage to zero
- ▶ Intention to reduce revolving credit facility to £300m in 2020



Our principal risks and uncertainties continued

Risk unchanged ➡

Risk decreased ↘

Risk increased ↗

7 Brexit

FY19 ➡

Detailed risk

SMS could be impacted by the UK's commitment to leave the European Union at the end of 2020.

- ▶ People – the impact of the UK government's Settled Status scheme on EU citizens who form part of the Group's workforce is unclear
- ▶ Supply chain – contractual arrangements, supply logistics and input costs through tariffs could be adversely impacted
- ▶ Funding – adverse movement in Sterling could lead to negative cost and funding implications for the Group

Potential impact

- ▶ Loss of specialism in workforce, particularly amongst engineering and information technology staff
- ▶ Interruptions or delays to the supply chain for goods sourced from within the EU, delays to customer orders and increased supplier costs
- ▶ Falling value of Sterling leads to higher import costs
- ▶ Increase in interest rates and higher cost of borrowing

Existing mitigating controls

- ▶ The Group continues to monitor and assess the impact of various scenarios in relation to Brexit
- ▶ SMS has conducted analysis over the number of EU employees within its business and considers the potential impact to be minimal
- ▶ We have performed a partner review with our critical suppliers which source supplies from outside the UK to ensure there are robust continuity arrangements in place in the event of adverse changes to trade arrangements including the failure to reach a trading agreement between the UK and EU
- ▶ We have sufficient coverage in our supply chain and inventory arrangements to withstand significant delays and to honour outstanding customer commitments
- ▶ Recently extended revolving credit facility agreed with banking consortium
- ▶ Continual review of hedging arrangements

8 Loss of required accreditations

FY19 ➡

Detailed risk

Loss of required accreditations or failure to comply with key regulatory requirements could lead to an inability to deliver our core services leading to a loss of revenue or reduction in banking facilities.

Potential impact

- ▶ Inability to conduct business
- ▶ Financial penalties
- ▶ Reputational damage
- ▶ Loss of trained and qualified engineers
- ▶ External investigation(s) and/or audits

Existing mitigating controls

- ▶ The Board has overall accountability for compliance with safety, health and environmental standards and is provided with regular management reporting
- ▶ Well-established Group technical assurance team in place, including an experienced Compliance function with deep industry insight and expertise
- ▶ Dedicated training academy for field service engineers
- ▶ Rolling training plan in place for all engineering staff to maintain and upgrade certifications
- ▶ Extensive assurance activity performed across the Group, by specialist assurance teams
- ▶ Regular external independent and routine audits performed by regulators
- ▶ Effective HR onboarding process for new staff including engineering team

9 Potential breach of the General Data Protection Regulation (GDPR)

FY19 ➡

Detailed risk

There could be a breach of GDPR through an internal failure to follow protocol and policy or as a result of data integrity and retention issues.

Potential impact

- ▶ Financial penalties under GDPR
- ▶ External investigation(s) by the Information Commissioner's Office
- ▶ Loss of customer and/or supplier confidence

Existing mitigating controls

- ▶ The General Counsel is an expert in data protection and is the appointed Data Protection Officer (DPO)
- ▶ The DPO monitors internal GDPR compliance and, through a series of internal and external communication platforms, informs and advises staff and third parties of our obligations and expectations under GDPR
- ▶ Annual GDPR training for all SMS staff

The Strategic Report is approved by the Board of Directors on 17 March 2020 and signed on its behalf below.

On behalf of the Board

DAVID THOMPSON
Chief Financial Officer
17 March 2020



Creating a culture of strong corporate governance

Corporate governance

It is the Board's role to ensure that the Group is managed for the long-term benefit of all of its stakeholders. We believe in effective and efficient decision making in a manner that incorporates the needs of our many stakeholders. Corporate governance is one of the important parts of the Group's strategy and our aim of continual improvement of our processes and risk management, whilst supporting the continued growth of the business, is vital in the ever-evolving corporate governance regime we adhere to.

In 2018, the Company adopted the provisions of the Quoted Companies Alliance's Corporate Governance Code (the QCA Code), published in April 2018. The Company continues to adopt the QCA Code and this report sets out how compliance is achieved and, if the Company departs from the terms of the QCA Code, an explanatory note detailing the reason for the departure.

I am delighted to confirm that we continue to comply with all the principles of the QCA Code. Whilst the Company does not currently adopt the UK Corporate Governance Code, published in 2018, we endeavour to stay up to date with its requirements and continue to adopt certain elements of it, where appropriate.

In addition, the Company has reviewed the Companies (Miscellaneous Reporting) Regulations 2018 (MRR), issued in July 2018 and applicable from 1 January 2019, and ensured that all additional provisions have been complied with, to the extent that they apply to the Company. Our section 172(1) statement, and details regarding stakeholder interests, can be found on pages 18 to 22. Employee engagement is discussed in the Directors' Report on pages 71 to 73 with additional details in our Sustainability Report on pages 38 to 41.

The enhanced disclosure requirements around executive pay, including the disclosure of our CEO pay ratio, are not applicable for the Company as we do not meet the definition of "quoted" under the Companies Act 2016.

We are confident that our proven approach to corporate governance will help to shape a robust and strong organisation as we deliver our strategic plan and take the business into the next phase of its growth and development.

Changes to the Board

There were two key changes to the Board during the year.

Tim Mortlock was appointed as Executive Director and Chief Operating Officer with effect from 17 September 2019. This represents the Company's first Chief Operating Officer appointment as an Executive Director position, a key appointment to reflect the recent growth of the Company and support its continued development. Tim holds over two decades of experience within the Group and previously held the position of Managing Director of our asset management and energy management divisions. His experience and knowledge of the industry within which we operate ensures that he can successfully adopt this new role and he is a strong addition to the Board and Executive team.

In addition, we appointed Ruth Leak as Non-Executive Director, following the resignation of Kelly Olsen during 2018. Ruth joined the Board with effect from 29 May 2019. An information technology specialist, with extensive commercial experience, Ruth is Chair of the Information Technology Committee and a valuable addition, with technology a core focus for the Group.

Further details on the Board's composition are given on pages 50 and 54.

Stakeholder engagement

Engagement with our stakeholders is an important priority for SMS. It strengthens our relationships and helps the business make the best decisions, which enable it to deliver on its commitments. The Board recognises its responsibility to understand and consider stakeholder views as part of its decision-making process and remains committed to fostering effective business relationships. More information on how the Board considers stakeholders is on pages 18 to 22 and details of how the Board engaged with shareholders during the year are on pages 57 to 58.

Looking ahead

As we look forward to celebrating our 25th anniversary, we are proud to reflect on our significant growth, development and continued achievements. We continue to be driven by our core values of investing in our people, systems and capacity to create a secure foundation for future growth.

A culture of strong corporate governance is an essential element of that, and business activities will be monitored to ensure that they are carried out in line with the robust governance framework that SMS aims to uphold.

WILLIE MACDIARMID
Non-executive Chairman
17 March 2020



WILLIE MACDIARMID
Non-executive Chairman



Date of appointment

14 April 2014,
Chairman 26 May 2016

Background and experience

Willie is a very experienced non-executive and executive director. He acts as an independent consultant for a number of companies and has held several senior posts across various sectors. Amongst a number of previous senior positions, he was formerly interim CEO at Barchester Healthcare, CEO of May Gurney, a main board director at Eaga PLC and on the executive board of ScottishPower for ten years. ScottishPower's successful metering business was part of his portfolio. Willie was formerly a non-executive director at Grove, the holding company for Barchester Healthcare and Business Stream (Retail Water and Waste). In April 2019, he was appointed to the board of Murgitroyd Group Plc, a European patent and trademark attorney practice, as non-executive director and deputy chairman. He resigned from this position following the sale of Murgitroyd in October 2019.

External appointments

Willie is currently chairman of Fallago Rig, a joint venture between Hermes Capital and EDF Renewables, and chairman of Ogilvie Group, a Stirling-based family owned business with interests spanning construction, fleet hire and IT. Willie also works with senior executives across various industries mentoring and providing one-to-one coaching.



ALAN FOY
Chief Executive Officer



Date of appointment

24 December 2007

Background and experience

Alan has been Chief Executive Officer of SMS since 2007. He led the flotation of the Company on the London Stock Exchange AIM in July 2011 and, since then, annual turnover and profits have risen significantly through a combination of strategic acquisitions and organic growth. Prior to joining SMS in 2004, Alan worked for ScottishPower and, in 1997, gained approval to establish its regulated gas transportation and metering business, SP Gas Ltd, which under his management grew to become a major gas transporter in the UK. He was previously a director of an international energy consultancy practice and has considerable experience in utility asset ownership, supply and shipping activities.

A professionally qualified engineer, Alan places strong emphasis on team development, safety, operational performance and financial accountability within an ethos of customer satisfaction.

External appointments

None.



DAVID THOMPSON
Chief Financial Officer

Date of appointment

11 September 2017

Background and experience

A Chartered Accountant, David has extensive experience in the finance and utility industries and operated at both divisional and Group Finance Director level within SMS prior to appointment as Chief Financial Officer. Before joining SMS, David held senior finance roles at Energetics Multi-Utility Group, a company owned by Macquarie Bank, and prior to that he held audit director posts at PwC LLP and Johnston Carmichael LLP.

External appointments

None.



TIM MORTLOCK
Chief Operating Officer

Date of appointment

17 September 2019

Background and experience

A Chartered Director, Tim has 20 years' experience in the energy and utility industry across utility connections, smart metering, data and energy services. Tim has been part of the UPL business (acquired by SMS in 2014) almost since its inception and, prior to taking up his current role as Chief Operating Officer, he was Managing Director of SMS's asset management, data and energy management businesses.

Tim has expert knowledge of electricity and gas smart metering, having been responsible for setting up the SMS electricity metering business following deregulation in 2004. Health and safety have always been at the heart of the electricity metering business, which is recognised for its quality of service delivery and installation activity.

External appointments

None.



MIRIAM GREENWOOD, OBE DL
Senior Independent
Non-executive Director



Date of appointment
3 February 2014

Background and experience

With qualifications as a barrister and in corporate finance, Miriam has spent more than 30 years working for a number of leading investment banks and other financial institutions. She was, for nine years until 2013, a non-executive director of the Gas and Electricity Markets Authority (Ofgem) and thus has extensive experience in the energy and utilities industry. Miriam was a founding partner in SPARK Advisory Partners, an independent corporate advisory business, and was formerly a non-executive director at Ofgem, Mithras Investment Trust plc and Telit Communications plc and was chair of the Expert Panel for the Gas Network Innovation Competition.

External appointments

Miriam is a non-executive director and chair of the remuneration committee at River and Mercantile Group plc and at Eclipse Shipping Limited. She is an adviser to Ofgem on the current RII02 price control and to the Mayor of London's Energy Efficiency Fund. A Deputy Lieutenant of the City of Edinburgh, Miriam was awarded an OBE for services to corporate finance.



GRAEME BISSETT
Independent Non-executive
Director



Date of appointment
1 June 2016

Background and experience

Graeme is an experienced corporate financier and qualified Chartered Accountant, having previously been a partner with Arthur Andersen LLP and finance director of international groups. He has formerly served on the boards of a number of other companies, including Macfarlane Group plc, Interbulk plc, The Scottish Futures Trust Limited and Belhaven Group plc.

External appointments

Graeme is a non-executive director of Cruden Group Limited, Anderson Strathern LLP and Aberforth Split Level Income Trust plc and undertakes a number of pro bono appointments, including as a member of Court at the University of Glasgow, trustee of Citizens Advice Scotland and trustee of the Entrepreneurial Scotland Foundation.



RUTH LEAK
Independent Non-executive
Director



Date of appointment
29 May 2019

Background and experience

Following a varied early career in different sectors, Ruth has specialised in business transformation through the use of technology.

Skilled in delivering scaled and usable systems that make a difference to companies and their customers, Ruth most recently served as chief information officer for the Letters and Network division of the Royal Mail, an organisation where she spent ten years. Ruth also served as chair of the Disability Steering Group, encouraging open communication and respect for diversity at all levels as well as seeking technology-based solutions for challenges in the workplace. Prior to Royal Mail, Ruth started her career in operational roles with Procter & Gamble, and then worked in consultancy for Coopers & Lybrand. Following a period at Debenhams she was part of the start-up team behind the British online supermarket Ocado, before honing her commercial and delivery skills further with consultancy Kurt Salmon Associates.

External appointments

Ruth is a founding partner in RDL Partners, an independent technology advisory business. During 2019, Ruth was also appointed as event chair for CIO Watercooler, a company that organises events to support networking activity for senior individuals across the technology industry.



CRAIG MCGINN
Group Company Secretary and
General Counsel for the Group

Background and experience

Craig is a qualified corporate and banking lawyer with over 20 years of experience and has responsibility for the management of all legal matters affecting the Group, for ethical risk matters and for supporting the Board in setting and maintaining standards of corporate governance. He is a Qualified Solicitor in Scotland, England and Wales and a member of the International Association of Privacy Professionals (IAPP). Craig joined SMS in October 2016 having previously been a partner in the international legal firm CMS Cameron McKenna, and Dundas & Wilson prior to its merger with CMS. Prior to joining Dundas & Wilson in 2004, Craig was a member of the in-house legal team at Bank of Scotland.

Key to Committees

- Audit
- Nomination
- Remuneration
- Information Technology
- Chair

The Board

Board structure

The Company is led by a strong and experienced Board of Directors (the Board) which brings a depth and diversity of expertise to the leadership of the Company. The Board has an appropriate balance of skills, experience and knowledge of the Group and its market to enable it to discharge its responsibilities effectively. Following the appointment of Tim Mortlock as Chief Operating Officer and Ruth Leak as independent Non-executive Director and Chair of the Information Technology Committee, the Board now has seven members, comprising three Executive Directors, the Non-executive Chairman and three independent Non-executive Directors. The Board has a breadth of experience across the utility sector, engineering, technology, finance, legal and corporate finance which are essential elements required to support the delivery of the Group's strategy over the medium to long term.

The Board currently comprises:

- ▶ the Chairman, Willie MacDiarmid;
- ▶ the Chief Executive Officer, Alan Foy;
- ▶ the Chief Financial Officer, David Thompson;

- ▶ the Chief Operating Officer, Tim Mortlock; and
- ▶ Non-executive Directors, Miriam Greenwood, Graeme Bissett and Ruth Leak.

The details of each Director are set out in the Board of Directors section of this report. Willie MacDiarmid, Miriam Greenwood, Graeme Bissett and Ruth Leak are considered to be independent Non-executive Directors.

The roles of Chairman and Chief Executive Officer are separate and there is a clear division of responsibilities between those roles.

The Chairman leads the Board and ensures the effective engagement and contribution of all Non-executive and Executive Directors. The Chairman also ensures that Board meetings take place with a culture of openness and challenge, with sufficient time made available to debate the matters arising. The Chief Executive Officer has responsibility for all Group businesses and acts in accordance with the authority delegated from the Board.

The responsibilities of the roles within the Board are set out as below:

Role	Responsibility
Chairman	Responsible for leading the Board, its effectiveness and governance, setting the agenda to take full account of the issues and concerns of the Directors and ensuring the links between the shareholders, Board and management are strong.
Chief Executive Officer	Responsible for the day-to-day leadership, management and control of the Group, recommending the Group strategy to the Board and ensuring that the strategy and decisions of the Board are implemented via management.
Chief Financial Officer	Responsible for the day-to-day financial management and sustainability of the Group and providing general support to the Chief Executive Officer including the financial and operational performance of the business.
Chief Operating Officer	Responsible for supporting the work of the Chief Executive Officer, providing oversight and leadership to the business divisions of the Group and having responsibility for IT and people management.
Senior Independent Director	Provides a sounding board for the Chairman, acts as an intermediary for the other Directors when necessary and is available to meet with shareholders.
Independent Non-executive Directors	Constructively challenge the Executive Directors and monitor the delivery of the Group strategy within the risk and control environment set by the Board.
Company Secretary	Supports the Chairman and Chief Executive Officer and is available to all Directors for advice and support. Informs the Board and Committees on governance matters and is responsible for development.

Miriam Greenwood is the Senior Independent Non-executive Director. She is available to shareholders if they have concerns which have not been resolved via the normal channels of Chairman, Chief Executive Officer or the other Executive Directors, or where communication through such channels would be inappropriate.

The Board considers each of the Non-executive Directors and the Chairman to be independent.

All of the Directors are subject to election by shareholders at the first Annual General Meeting (AGM) after their appointment to the Board and to re-election by shareholders at least once every three years. In addition, any Non-executive Director who has served on the Board for more than nine years will be subject to annual re-election.

The Chairman and Non-executive Directors have other third-party commitments including directorships of other companies as set out in their biographies. The Company is satisfied that these associated commitments have no measurable impact on their ability to discharge their responsibilities effectively. The Executive Directors have no third-party commitments.

The Company maintained a Directors' and officers' liability insurance policy throughout the financial year and has renewed that policy.

Role of the Board

It is the Board's role to ensure that the Group is managed for the long-term benefit of all its stakeholders. We believe in effective and efficient decision making in a manner that incorporates the needs of our many stakeholders. Corporate governance is one of the important parts of the Group's strategy and our aim of continual improvement of our processes and risk management, whilst supporting the continued growth of the business, is vital in the ever-evolving corporate governance regime we adhere to.

There is a formal schedule of matters reserved for the Board, including approval of:

- ▶ the Group's annual budget;
- ▶ the Group's strategy;
- ▶ acquisitions, disposals and capital expenditure or investment projects above certain thresholds;
- ▶ the Annual Report and any reports or information to be issued to shareholders of the Company;
- ▶ the Company's share dealing policy;
- ▶ the appointment of the Company's independent auditor;
- ▶ the Company's dividend policy and borrowing powers;
- ▶ any material changes to the Company's accounting policies or insurance policies;
- ▶ remuneration of Directors, Executive officers and senior employees;
- ▶ alterations to the constitutional documents of the Company;
- ▶ the adoption of any new, or amendments to, major employee benefit plans;
- ▶ legal actions brought by or against the Group above certain thresholds;
- ▶ political and charitable donations; and
- ▶ the scope of delegations and appointments to Board Committees and subsidiary Boards.

Responsibility for the development of policy and strategy and operational management is delegated to the Executive Directors and senior management team.

Board evaluation

Each year, the Company executes a performance evaluation process for the Board, its Committees and individual Directors. This process gives the Directors the opportunity to identify areas for improvement both jointly and individually using questionnaires, one-to-one sessions with the Chairman and open discussion.

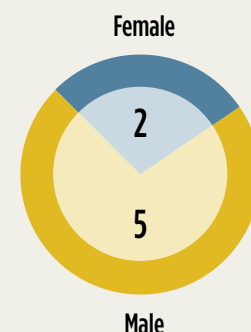
As part of the annual performance evaluation of the Board, the Non-executive Directors met, led by the Senior Independent Director and without the Chairman present, to appraise the Chairman's performance. There were also discussions between the Chairman and the Non-executive Directors, without the Executive Directors present, to discuss feedback for each Executive Director in advance of their appraisals.

During 2019, the Company sought feedback informally, at the end of each Board meeting, in order to provide Directors with current, relevant thoughts and reflections.

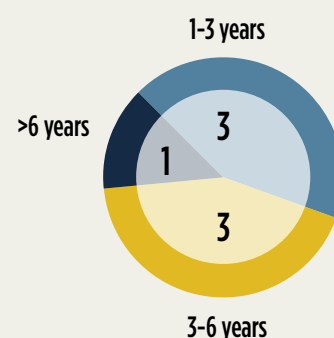
The following focus areas were amongst those identified from the 2018 evaluation process, acted upon during 2019:

Diversity, independence and experience

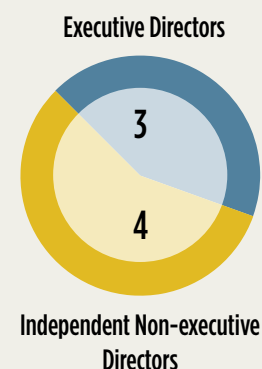
Gender



Tenure

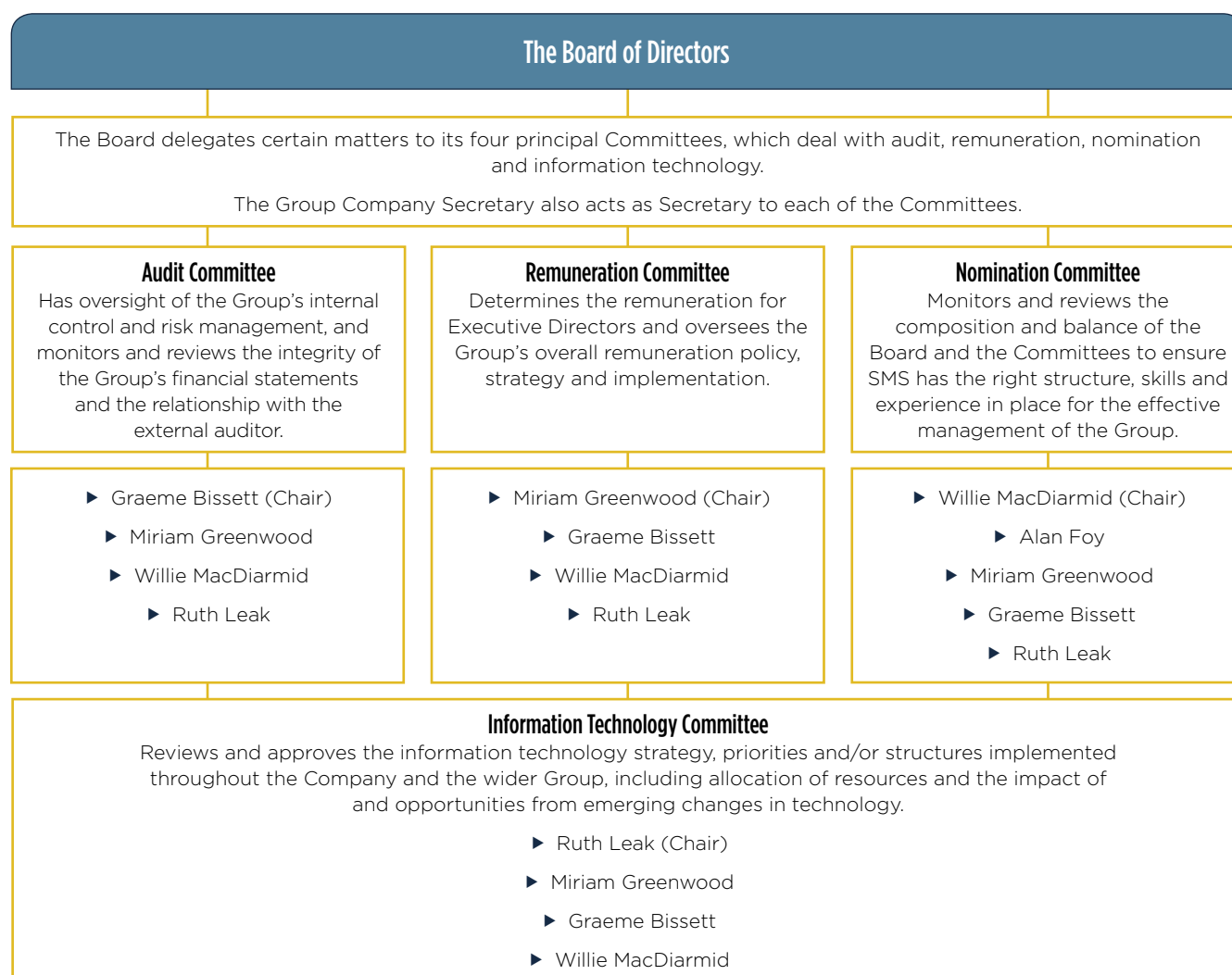


Board composition



Sector experience

Technology	4
Finance	2
Mergers and acquisitions	4
Marketing	2
Sales	3



Board evaluation continued

- Ensuring the Board is focused on the significant issues and the appropriate amount of time for debate is available. Feedback was taken at the end of each Board meeting to ensure that all the Board members were satisfied that was the case.
- The Board requested updates on the marketplace, competitors and customers. This was included in the Board reports submitted by the Chief Executive Officer and Chief Operating Officer during 2019.
- Ensuring that appropriate succession planning for all Non-executive Directors and Executive Directors was regularly considered. This was addressed by ensuring a minimum of two Nominations Committee meetings were held during the year. Succession planning is a matter reserved for the Executive Directors and the Non-executive Directors. A paper covering the subject is produced and reviewed by both the Nomination and Remuneration Committees when carrying out succession planning. The Board's policy is for the Board to have a broad range of skills, background and experience.

There were no significant, additional focus areas arising from the 2019 feedback process.

The intention is that a performance evaluation of the Board, the Board Committees and individual Directors continues to be conducted annually. The Board intends to revert to a more formal system of evaluation in 2020 and is considering the use of a third-party facilitator for that process.

Independent advice

All Directors are able to take independent professional advice in the furtherance of their duties, if necessary, at the Company's expense.

All Directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed, and that applicable rules and regulations are complied with. The appointment and removal of the Company Secretary is a matter for the Board as a whole. All Directors are supplied with information in a timely manner in a form, and of a quality, appropriate to enable them to discharge their duties.

In addition, the Company Secretary ensures that the Directors receive appropriate training where necessary. Regular training is provided on relevant topics such as health and safety, AIM Rules and the Market Abuse Regulation and these programmes run continuously through the year. Refresher training on the AIM Rules and Market Abuse Regulation was provided by a third party to the entire Board in the first half of the year. All Directors are encouraged to keep themselves up to date with regard to changes in industry, practice and regulations and the Company continuously assesses its training programmes to ensure they are relevant and up to date.

Board meetings and attendance

Board meetings are scheduled to be held eight times each year. Between these meetings, as required, additional Board meetings and Board Committee meetings may be held to progress the Company's business. A part of each Board meeting is dedicated to the discussion of specific strategy matters. Any conflicts of interest are declared at the start of each Board meeting and appropriate action is taken where necessary to ensure independent judgement is not overridden. Half of the Board, excluding the Chairman, are considered independent, which helps to address any conflicts of interest that may arise. There were no registered potential conflicts during 2019.

In 2019, the Board held ten scheduled meetings. At each meeting the Board received reports from:

- ▶ the Chief Executive Officer on health and safety, strategic, operational and business developments, and investor relations;
- ▶ the Chief Financial Officer on the financial performance of the business, budget, funding and capital; and
- ▶ each of the Board Committees on matters discussed at their meetings.

Board activities are structured to develop the Group's strategy and to enable the Board to support management on the delivery of the Group's strategy within a transparent governance framework. The Board also regularly discussed governance, risk and reputation management and financial performance.

In advance of all Board meetings the Directors are supplied with detailed and comprehensive papers covering the Group's operating functions.

The Company Secretary is responsible to the Board for the timeliness and quality of information provided to it.

The Chairman holds meetings with the Non-executive Directors during the year without the Executive Directors being present.

The list below sets out a non-exhaustive list of the key areas of focus for the Board's activities and topics discussed during the year to 31 December 2019:

- ▶ **Fit for growth** – preparation of the 2020 budget, structure of the debt facility, interim 2019 dividend and the Group dividend policy, business development opportunities and product strategy. During 2019, the Board has been engaged in evaluating the strategic direction for the business. This has included making the decision to acquire a new entity, Solo Energy. See page 22 for further details on this principal decision. There were also initial discussions in the year regarding the potential monetisation of a minority of our meter assets. A final decision was made on this in early 2020, as reported in the Strategic Report.
- ▶ **Performance** – at every meeting, the Board discussed the Chief Executive Officer's report on performance of operations, the Chief Financial Officer's report on financial performance and quarterly market metrics. Performance was assessed against the approved budget and variances understood in the context of market and industry developments.
- ▶ **Governance** – full-year preliminary results, Annual Report, notice of AGM and final dividend recommendation, half-yearly results and interim dividend recommendation, Modern Slavery Act, matters reserved for the Board, Committees' terms of reference, Board effectiveness review and gender pay gap.
- ▶ **Risk and regulatory** – annual compliance and risk reports and year-end assessment of internal control systems, presentation on GDPR, risk tolerance and risk.

The attendance of Directors at scheduled Board and Committee meetings in the year to 31 December 2019 is set out below. All of the Directors who were entitled to attend those Board meetings attended each Board meeting.

	Board Maximum 10	Audit Committee Maximum 4	Remuneration Committee Maximum 4	Nomination Committee Maximum 2	Information Technology Committee Maximum 1
Executive Directors					
A H Foy ¹	●●●●●●●●●●	●●●●●	●●●●●	●●	●
D Thompson ¹	●●●●●●●●●●	●●●●●	—	—	●
T Mortlock ^{1,2}	●●●●	●	—	—	●
Non-executive Directors					
W MacDiarmid	●●●●●●●●●●	●●●●●	●●●●●	●●	●
M Greenwood	●●●●●●●●●●	●●●●●	●●●●●	●●	●
G Bissett	●●●●●●●●●●	●●●●●	●●●●●	●●	●
R Leak ³	●●●●●●●●●	●●	●●●●	●	●

¹ A H Foy, D Thompson and T Mortlock attended the Audit Committee meetings and Information Technology Committee meetings by invitation. A H Foy also attended the Remuneration Committee meetings by invitation.

² T Mortlock was appointed as an Executive Director on 17 September 2019 and attended all the Board and Board Committee meetings that took place from that date.

³ R Leak was appointed as a Non-executive Director on 29 May 2019 and attended all the Board and Board Committee meetings that took place from that date.

Committees of the Board

The terms of reference of the Audit, Remuneration, Nomination and Information Technology Committees, the principal Committees of the Board, have been approved by the Board and are available on the Company's website (www.sms-plc.com) under the Corporate Governance section of the website.

These terms of reference are reviewed annually and have been reviewed in the current year.

During 2019, the terms of reference for the Information Technology Committee were updated following the appointment of Ruth Leak as Chair. Amendments were primarily administrative in nature with additional clarity provided around the role of the Committee. The updated duties are disclosed below.

There were no amendments to the terms of reference for the other Board Committees.

The work carried out by the Audit Committee is described within the Audit Committee's Report on pages 59 to 61. The work carried out by the Nomination Committee in discharging its responsibilities is described within the Nomination Committee's Report on page 62. The work carried out by the Remuneration Committee is described within the Remuneration Committee's Report on pages 63 to 70.

Audit Committee

During the year the Audit Committee comprised Graeme Bissett (Chair), Miriam Greenwood, Willie MacDiarmid and Ruth Leak. Meetings are also attended, by invitation, by the Chief Executive Officer, Chief Financial Officer and Head of Internal Audit.

The Audit Committee's role is to assist the Board with the discharge of its responsibilities in relation to financial reporting including reviewing the Group's Annual Report and Accounts and half-year financial statements, reviewing and monitoring the scope of the annual audit and the extent of non-audit work undertaken by the external auditor, and advising on the appointment of the external auditor. It also reviews the effectiveness of the Group Internal Audit function in the overall context of the Group's risk management system, internal controls, whistleblowing and fraud systems in place within the Group.

The Audit Committee meets at least three times in each financial year and has unrestricted access to the Group's external auditor.

Remuneration Committee

The Remuneration Committee is responsible for reviewing and making recommendations to the Board on the total remuneration for the Executive Directors and senior management. The Remuneration Committee oversees the Group's remuneration policy, strategy and implementation to ensure that the policy delivers on the key objectives of growing earnings and delivering strong returns, in alignment with external shareholders.

The Remuneration Committee comprises Miriam Greenwood (Chair), Willie MacDiarmid, Graeme Bissett and Ruth Leak. The Remuneration Committee meets a minimum of twice a year.

The Remuneration Committee reviews the performance of the Executive Directors and makes recommendations to the Board on matters relating to their remuneration and terms of service.

The Remuneration Committee also makes recommendations to the Board on proposals for the granting of share options

and other equity incentives pursuant to any employee share option scheme or equity incentive plans in operation from time to time.

Nomination Committee

The Nomination Committee is chaired by Willie MacDiarmid and comprises Miriam Greenwood, Graeme Bissett, Ruth Leak and Alan Foy.

The Nomination Committee considers the selection and re-appointment of Directors. It identifies and nominates candidates to fill Board vacancies and regularly reviews the structure, size and composition (including the skills, knowledge and experience) of the Board and makes recommendations to the Board with regard to any changes.

At present all Directors are appointed for a period of three years. As the Company continues to grow significantly in a very active market the retention of high-performing Directors to lead the Company is seen as essential in delivering shareholder value and developing the maturity and governance of the Company through a period of significant growth.

No particular targets have been set for developing a diverse pipeline of Directors, but the Nomination Committee fully recognises the benefits of greater diversity and will continue to take account of this when considering any particular appointment. It will continue to ensure that the best people are appointed for the relevant roles.

Information Technology Committee

The Information Technology Committee has been chaired by Ruth Leak, an information technology specialist, from the date of her appointment, and comprised Graeme Bissett, Miriam Greenwood and Willie MacDiarmid. Alan Foy, David Thompson and Tim Mortlock attended by invitation.

The Information Technology Committee is responsible for the review and approval of the SMS information technology strategy. It reviews and monitors the ongoing allocation of resources and funding required to deliver the implementation of this strategy and oversees the development and implementation of those information technology projects deemed to be of significant importance to the Group. The Committee ensures appropriate information technology standards and procedures are in place, including those related to the General Data Protection Regulation (GDPR) and, in close liaison with the Audit Committee, it ensures that information and technology risks are identified, assessed and managed with actions implemented as appropriate.

During the year, the Committee oversaw the continued investment the Group is making in a new Group-wide Enterprise Resource Planning (ERP) system. This is a business-wide transformation project which will consolidate, integrate and update our accounting, stock, fixed asset and field management systems and processes to ensure that we can effectively manage the increasing volumes of transactions and complexity of data. The first phase of the project was delivered in the final quarter of 2019 and saw the Group's division in Cardiff successfully onboarded onto the new system.

In addition, in February 2020, the Company achieved ISO 27001 security certification. This was a significant project, with contributions from all parts of our business to bring it to a successful conclusion. It is a significant milestone in enhancing the Company's approach to information security, securing the SMS environment and protecting our assets and data. This accreditation is just one part of an ongoing journey to uphold and continually improve the standards the Company operates under.

Accountability

Internal control

The Board has overall responsibility for the Group's system of internal control and risk management and for reviewing the effectiveness of this system. It is supported by the Audit Committee in reviewing the effectiveness of the Group's risk process and internal control systems. Such a system can only be designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can therefore only provide reasonable and not absolute assurance against material misstatement or loss.

Business performance is regularly reviewed by the Board through the monitoring of:

- ▶ progress towards strategic objectives;
- ▶ the Group's financial performance, including budgeting and forecasting, financial reporting, analysing variances against plan and taking appropriate management action;
- ▶ capital investment; and
- ▶ principal risks and the process by which these are evaluated and managed on a continuous basis.

The Board has reviewed the effectiveness of the Group's risk management and internal control systems, including financial, operational and compliance controls. A robust assessment of the principal risks faced by the Group has also been undertaken.

Whistleblowing

The Group encourages staff to report any concerns which they feel need to be brought to the attention of management concerning any possible impropriety, financial or otherwise. The Group has put in place a whistleblowing procedure where employees can confidentially report any concerns or wrongdoing. This may be used to report incidents of fraud, bribery and corruption, discrimination, bullying or harassment, breaches of the Group's health and safety or quality compliance or environmental concerns. The Group provides the Audit Committee with information in relation to matters reported, any subsequent investigation and follow-up actions.

Relationship with shareholders

The Board recognises the importance of maintaining an open, transparent and two-way communication with shareholders. This ensures a mutual understanding of objectives: for shareholders to understand the Group's strategy and for the Board to be aware of shareholders' feedback and any issues raised.

During the last financial year, the Executive Directors, assisted by the Investor Relations team, attended several meetings, conferences and roadshows to maintain regular communication with both institutional and private investors. The Group's Non-executive Directors have also been available to meet shareholders should they wish to raise issues without the Executive Directors present.

Shareholder activities in the year

The Board receives monthly updates from the Investor Relations team, Chief Executive Officer and Chief Financial Officer on shareholder engagement. These updates include share price performance, composition of the shareholder register, key topics of discussions with shareholders, peer group comparison and feedback on analyst reports, brokers and PR partners.

On the day of interim and full-year results announcements, equity research analysts are invited to attend management's presentation, which is followed by a question and answer session addressed by the Chief Executive Officer, Chief Financial Officer and Chief Operating Officer. One-to-one and Group meetings are then held with existing institutional shareholders and potential new investors.

Results and news releases on topics such as contract wins, significant accreditations, acquisitions and new strategic initiatives are published via the London Stock Exchange RNS and on the Company's investor website at www.sms-plc.com. The Group's website also provides a full spectrum of history, news, business developments and investor relations topics including a repository of past presentations and announcements.

We will continue to disclose information appropriately to satisfy the needs of shareholders and investors, thereby enhancing understanding of our business.

Annual General Meeting

The 2020 AGM will be held in Summer 2020 in Glasgow. Full information will be provided in the notice of AGM, to be posted separately to shareholders, and will be available to download from the Company's website at www.sms-plc.com.

The AGM is an important forum for shareholders, particularly private shareholders, to hear more about the general development of the business. The Chairman and the Chairs of the Audit and Remuneration Committees will be present at the AGM allowing shareholders an opportunity to ask questions, engage with members of the Board and learn more about the Company.

The Chairman is also available to answer questions throughout the year, upon request by investors. If investors have any matters that they wish to raise outside the timing of the AGM these can be raised using the contact details on the Group's website.

Relationship with other stakeholders

Engaging with our stakeholders strengthens our relationships and helps the business make better decisions that enable it to deliver on its commitments. The Board is regularly updated on wider stakeholder engagement feedback to stay abreast of stakeholder insights into the issues that matter most to them and the business, and to enable the Board to understand and consider these issues in its decision making. See further details on our stakeholder engagement on pages 18 to 22.

In addition to our shareholders, suppliers and customers, our employees are one of our most important stakeholder groups. The Board closely monitors and reviews the results of all of its employee engagement as well as any other feedback it receives to ensure alignment of interests. See further details on our people and development strategies in the Sustainability Report on pages 38 to 41.

Shareholder activities in the year

Apr 19

- ▶ Full-year 2018 results presentation
- ▶ Full-year 2018 results roadshow, London
- ▶ Full-year 2018 results roadshow, Edinburgh

May 19

- ▶ AGM

Jun 19

- ▶ Private client fund manager roadshow in Leeds, Liverpool and Manchester
- ▶ Peel Hunt Industrials and Support Services Conference

Jul 19

- ▶ H1 2019 trading update and calls with investors

Sep 19

- ▶ H1 2019 results presentation
- ▶ H1 2019 results roadshow, London
- ▶ H1 2019 results roadshow, Edinburgh

Oct 19

- ▶ Macquarie Green Energy Conference

Nov 19

- ▶ Investec Best Ideas Conference

Jan 20

- ▶ Citi SMID Conference
- ▶ FY 2019 trading update and calls with investors

Other matters

Promoting an ethical corporate culture

Various indicators are used to monitor and provide insight into the Group's culture, including employee engagement, health, safety and wellbeing measures and diversity indicators. See further details on pages 38 to 41. The state of the Group's culture is assessed through compliance reviews, internal audits and the provision of formal and informal channels for employees to speak up, including a whistleblowing hotline that allows employees to make disclosures in confidence. The Company ensures action is taken to address behaviour that falls short of the Company's expectations. The Board believes that in a fast-growing business like the Group, both in terms of employee numbers and overall size of the business, the mix of informal and formal channels provides a faster and more robust process to address matters raised by the workforce. Where Directors have concerns about the operation of the Board or the management of the Company that cannot be resolved, their concerns are recorded in the minutes of the Board meetings. On their resignation, a Non-executive Director has the opportunity to provide a written statement to the Chairman, for circulation to the Board, if they have any concerns about the operation of the Board or the management.

UK withdrawal from the European Union

The UK has now left the EU and is currently in a transition period until the end of 2020 whilst the UK and the EU negotiate future arrangements. There is uncertainty surrounding the results of these negotiations and whether the transition period will be extended.

The Board has followed developments through the year and maintained an active dialogue to identify and address any potential risks for the Group. Consistent with the prior year, our review work shows that Brexit should not have a material impact on our business activities, which predominantly take place within the UK (see the detailed risk assessment on page 48). We will continue to monitor the situation closely over the next twelve months as future arrangements are finalised.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in the Strategic Report on pages 1 to 48. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Financial Review on pages 29 to 33 together with the impact of the asset disposal contingently agreed on 12 March 2020. The Directors confirm that, having given consideration to various outcomes of future performance and forecast capital expenditure, together with the intended refinancing of the loan facility and the cash that will be generated upon completion of the asset disposal, they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future (being at least one year following the date of approval of this Annual Report). For this reason, they consider it appropriate to adopt the going concern basis in preparing the financial statements.

On behalf of the Board

WILLIE MACDIARMID

Non-executive Chairman

17 March 2020



Providing oversight of the Group's internal controls

Members and attendance

	Meetings
Graeme Bissett (Chair)	●●●●●
Miriam Greenwood	●●●●●
Willie MacDiarmid	●●●●●
Ruth Leak ¹	●●

Attending by invitation

Chief Executive Officer	●●●●●
Chief Financial Officer	●●●●●
Chief Operating Officer ²	●
Head of Internal Audit	●●●●●
External auditor	●●●●●

¹ Ruth Leak was appointed on 29 May 2019 and attended all Audit Committee meetings following her appointment.

² The Chief Operating Officer was appointed on 17 September 2019 and attended all Audit Committee meetings following his appointment.

Role of the Committee

- ▶ Monitoring the integrity of the financial statements, including reviewing significant financial reporting issues and judgements alongside the findings of the external auditor.
- ▶ Advising the Board on the effectiveness of the fair, balanced and understandable nature of the Annual Report.
- ▶ Overseeing the relationship with the external auditor, the external audit process and the nature and scope of the external audit, including the auditor's appointment, effectiveness, independence and fees.
- ▶ Overseeing the nature and scope of internal audit and co-ordination with the activities of the external auditor.
- ▶ Reviewing the effectiveness of the Group's systems for internal financial control, financial reporting and risk management.

Main activities in 2019

- ▶ Review and approval of interim and year-end financial statements and supporting schedules, including management papers on significant areas of judgement.
- ▶ Review of reports prepared by the external auditor, including its annual audit plan and a report on the year-end financial statements.
- ▶ Review and approval of the Group's annual Internal Audit Plan and oversight of the evolution of the Group's risk management and internal audit policies and procedures.
- ▶ Review of a report prepared by the FRC, following their inspection of the external auditor's audit of the Group's financial statements for the year ended 31 December 2018.

Audit Committee statement

The Committee comprises all the independent Non-executive Directors. It was chaired during the year under review by Graeme Bissett, who is a Chartered Accountant with recent and relevant financial experience. The other independent Non-executive Directors who served during the year are all deemed to have the necessary ability and experience to understand financial statements.

The Committee meets at least three times a year, generally just prior to Board meetings, to facilitate immediate and efficient reporting to the Board, with additional meetings where necessary. The external auditor, the Chief Executive Officer, the Chief Financial Officer and the Chief Operating Officer attend Committee meetings by invitation. The Committee also meets privately with the external auditor without management being present. The Chairman of the Committee maintains a regular dialogue with the Chief Financial Officer and his team, and with the Head of Group Internal Audit.

Objectives and responsibilities

The Committee's key objectives are to provide effective governance over the Group's financial reporting and the performance of the external auditor; to provide oversight of the Group's systems of internal financial control; and to report to the Board on these matters.

In fulfilment of these objectives the Committee:

- ▶ reviews SMS's financial statements and announcements and considers whether these statements and announcements provide a fair, balanced and understandable view of the strategy, business model and performance of the Group and of the associated risks;
- ▶ considers the appropriateness of accounting policies and significant accounting judgements and the disclosure of these in the financial statements;
- ▶ oversees the relationship with and performance of the external auditor; and
- ▶ reviews the effectiveness of financial controls and systems.

Internal control and risk management

The Committee has the primary responsibility for the oversight of the Group's internal control, including the risk management framework and the work of the Internal Audit function. The Group has in place an internal control environment to protect the business from the material risks which have been identified. Management is responsible for establishing and maintaining adequate internal controls over financial reporting and the Committee has responsibility for monitoring the effectiveness of these controls. Risk registers are maintained and regularly reviewed by management. The Board, including the Audit Committee, considers the principal risks, the nature and extent of the Company's risk management framework and the risk profile that is acceptable in order to achieve the Company's strategic objectives.

Internal audit

The Group Internal Audit function is independent and objective and its role, as defined in the Internal Audit Charter, is to add value and improve the organisation's operations and controls. The Head of Internal Audit reports functionally to the Audit Committee and administratively to the Executive Management Team. The Chair meets with the Head of Group Internal Audit periodically without executive management present to set annual objectives and discuss any significant or emerging issues. Group Internal Audit uses a risk-based approach to conduct several strategic and operational audits

throughout the year and these are reported and discussed at each Audit Committee meeting. Monitoring the scope, extent and effectiveness of the Group's Internal Audit activities is an agenda item at each Committee meeting. Group Internal Audit is also responsible for confirming that management actions and improvement points raised within each audit report have been implemented effectively and in a timely manner.

Throughout 2019, Group Internal Audit has worked with the Board, the Executive Management Team and members of management to support the continued development of a robust risk management framework upon which it can place reliance for identifying areas of risk to be considered for inclusion in the annual Internal Audit Plan. A full risk-based annual Internal Audit Plan for 2019 was reviewed and approved by the Committee in November 2018 and the Audit Plan for 2020 was approved by the Committee at the end of 2019. The Committee has remained in active discussion with Group Internal Audit around the existing risks the Group faces as it continues to grow, including the impact of industry and regulatory changes, systems development and pervasive external risks including cyber and data security.

Financial reporting and statutory audit

The Committee has reviewed with both management and the external auditor the annual financial statements, focusing on: the overall truth and fairness of the results and financial position, including the clarity of disclosures shown in the statements and their compliance with best practice requirements; the appropriateness of the accounting policies and practices used in arriving at those results; the resolution of significant accounting judgements or of matters raised by the external auditor during the course of its annual statutory audit; and the quality of the Annual Report taken as a whole, including disclosures on governance, strategy, risks and remuneration, and whether it gives a fair, balanced and understandable picture of the Group.

External audit

The Committee discussed, challenged and agreed with EY its detailed audit plans prepared in advance of the audit, which set out its assessment of key audit risks and materiality and key audit matters.

The selection of appropriate accounting policies and practices is the responsibility of management; the Committee discussed these with both management and the external auditor. Significant areas considered by the Committee in relation to the 2019 financial statements are set out on page 61.

Area of judgement	Matter considered	Action
Appropriateness of capitalisation of overheads and other expenses within meter assets	SMS continues to carry out a significant level of in-house installation of meter assets, certain costs of which are capitalised and depreciated as part of fixed asset depreciation.	<p>The Committee considered management's capitalisation process and the assumptions and judgements used when determining which costs are directly attributable to bringing the meter assets into use and eligible for capitalisation.</p> <p>The Committee was satisfied that the costs identified by management for capitalisation were appropriate, being directly attributable labour costs and an appropriate allocation of overheads.</p>
Identification of indicators of impairment of the meter asset portfolio in accordance with IAS 36 and assumptions applied in determining the carrying value of the portfolio of meter assets	<p>Due to the uncertainties associated with the timing of the domestic smart meter rollout, the expected useful life and carrying value of traditional meters requires significant judgement, together with the level of recoverability of termination income. These assumptions are used in deriving the depreciation rates applied and the impairment calculation performed on carrying value.</p> <p>Several factors are considered in assessing the expected pace of the smart meter replacement programme, including the number of smart meters still to be installed and the churn of assets.</p> <p>The revised UK-wide smart meter rollout plan proposed by BEIS in September 2019 has been assessed by the Group in relation to these carrying value considerations.</p>	<p>The Committee considered the judgements made by management, the quantum and disclosure of relevant amounts.</p> <p>The Committee confirmed with management that the financial statements include a reduction to the estimate of residual value on the domestic traditional meter asset portfolio to 0%, reflecting management's updated forecasts and assumptions regarding the recoverability of value on these assets. The Committee considered that judgements and estimates used in support of this revised estimate were reasonable. It was confirmed with management that there have been no other changes to accounting estimates with regard to property, plant and equipment.</p> <p>The Committee considered the accounting estimates and judgements used to arrive at the expected useful economic life of the traditional meter assets and their carrying value at 31 December 2019.</p> <p>Losses on disposal of de-appointed meters have been recognised after allowance for termination income and, following management's impairment assessment, no impairment charge was recorded at the end of the year. The financial statements provide detailed commentary on the estimates and judgements involved and on the financial effect. The Committee considers that the position presented in the financial statements provides a reasonable view of the carrying value of traditional meter assets.</p> <p>The Committee is satisfied that charges for losses on disposal, net of termination income, and for impairment of this asset class, should be recorded as exceptional items to assist understanding of the performance of the continuing meter estate comprising I&C meters and domestic smart meters as distinct from the effect of discontinued traditional meter assets. The Committee is also satisfied that amounts arising in relation to the loss of first-generation smart meter assets (SMETS1 meter assets) should be recorded as exceptional items, on the basis that these disposals are attributable to the temporary industry transition period.</p> <p>Overall, the Committee is satisfied that the approach taken by management to review the expected useful life and estimate the carrying value of meter assets is appropriate and the assumptions applied are sensible and supportable.</p>

During the year, an Audit Quality Review Team (AQRT) from the FRC undertook an inspection of EY's audit of the Group's financial statements for the year ended 31 December 2018. As part of that process, the Audit Committee Chairman spoke with the AQRT to share the Audit Committee's perspective on the quality of EY's audit. On completion of the review, the Audit Committee received and considered the AQRT's final report on its inspection and discussed it with the audit partner. The report gave the Committee no concerns over the quality, objectivity or independence of the audit.

The Committee considers a number of areas when reviewing the external auditor appointment, namely its performance in discharging the audit, the scope of the audit and terms of engagement, its independence and objectivity, and its re-appointment and remuneration. The Committee reviews the objectivity and independence of the auditor when considering re-appointment. The Committee has confirmed it is satisfied with the independence, objectivity and effectiveness of EY and has recommended to the Board that the auditor be re-appointed, and there will be a resolution to this effect at the forthcoming Annual General Meeting.

GRAEME BISSETT
Chair of the Audit Committee
 17 March 2020



Members and attendance

Meetings

Willie MacDiarmid (Chair)	● ●
Graeme Bissett	● ●
Miriam Greenwood	● ●
Ruth Leak ¹	●
Alan Foy	● ●

¹ Ruth Leak was appointed on 29 May 2019 and attended all Nomination Committee meetings following her appointment.

Role of the Committee

- ▶ To review the structure, size and composition (including skills, knowledge, experience, diversity and balance of Executive and Non-executive Directors) of the Board and its Committees and make recommendations to the Board with regard to any changes.
- ▶ Identify and nominate, for the approval of the Board, candidates to fill Board vacancies or expand the Board.
- ▶ Keep under review the time commitment expected from the Chairman and the Non-executive Directors.

The Nomination Committee is currently made up of one Executive Director and all the independent Non-executive Directors, each of whom is independent.

The Committee is chaired by the Chairman, unless the matter under discussion is their own succession. Other Directors are invited to attend as appropriate and only if they do not have a conflict of interest. The Committee is also assisted by executive search consultants as and when required.

Main activities in 2019

- ▶ Ruth Leak was appointed as Non-executive Director on 29 May 2019.
- ▶ Tim Mortlock was appointed as Executive Director and Chief Operating Officer on 17 September 2019.

You will see from the table that the Committee met on two occasions during the year. In addition, we held a number of informal meetings and discussions with the Chief Executive Officer and others.

Appointment of Executive Director and Chief Operating Officer

In September 2019, Tim Mortlock was appointed as Executive Director and Chief Operating Officer, a significant milestone for the Group and one that reflects the continued growth and development of our business. Tim was appointed following a re-evaluation of executive duties and capacity. There was extensive discussion by the Committee, and, on recommendation of the Chief Executive Officer, Alan Foy, a decision was reached that Tim, as an internal candidate, would be the best individual to take on the role.

Prior to the appointment, Tim was Managing Director of the asset management and energy management divisions, having been employed within the SMS Group of companies for over 20 years. His appointment is key in strengthening the Board during an important phase for the Group.

Appointment and resignation of Non-executive Director

Following the resignation of Kelly Olsen in October 2018, the Committee was pleased to appoint Ruth Leak as a Non-executive Director in May 2019. An information technology specialist with extensive commercial experience in a wide range of industries, Ruth has taken over as Chair of the Information Technology Committee of the Board, with a remit to review and provide strategic guidance on the continuing development of SMS's technology programmes.

Ruth was appointed in accordance with a standard external recruitment process. Consultants were briefed and the initial phase saw several potential candidates presented to the Company. A shortlist of candidates was selected for interview by two members of the Committee, after which two were selected for a final stage interview with a panel of other Directors (Executive and Non-executive). A final decision was subsequently made by the Board, following the recommendation of the Committee that Ruth be appointed.

Ruth's appointment was made using an external recruitment consultancy, which has no other connection with the Group except for the provision of Non-executive Director recruitment services.

Board composition and diversity

Our policy is to have a broad range of skills, backgrounds and experience.

We do not set any specific targets, but we fully recognise the benefits of greater diversity and will continue to take account of this when considering any particular appointment. We will continue to ensure that we appoint the best people for the relevant roles.

As the Group continues to develop, all Directors will be consulted on the composition of the Board in the context of this growth. This includes its size, the appropriate range of skills and the balance between Executive and Non-executive Directors, all of which are assessed as part of the annual Board evaluation process.

WILLIE MACDIARMID
Chair of the Nomination Committee
17 March 2020



Alignment with our strategic priorities

Members and attendance

	Meetings
Miriam Greenwood (Chair)	● ● ● ●
Willie MacDiarmid	● ● ● ●
Graeme Bissett	● ● ● ●
Ruth Leak ¹	● ● ●

¹ Ruth Leak was appointed on 29 May 2019 and attended all Remuneration Committee meetings following her appointment.

Role of the Committee

The Remuneration Committee is responsible for reviewing and making recommendations to the Board on the total remuneration for the Executive Directors and senior management. The Remuneration Committee oversees SMS's remuneration policy, strategy and implementation to ensure that the policy delivers on the key objectives of building a sustainable business, growing earnings and delivering strong returns for the benefit of all its stakeholders, including shareholders and its wider workforce.

The Remuneration Committee comprises all the independent Non-executive Directors and meets a minimum of twice a year. We invite attendance at the meetings, as appropriate, but no Executive Director is involved in any decision relating to their own remuneration.

The Committee's remit is as follows:

- ▶ to determine and recommend to the Board for approval the policy on total remuneration of the Executive Directors, and the monitoring of the effectiveness of the policy;
- ▶ to agree the performance KPIs, and corresponding targets, underpinning performance related pay schemes for the Executive Directors and senior management;
- ▶ to approve the total annual payments made under such schemes;
- ▶ to review and approve the design of all share incentive plans for approval by the Board and shareholders. For any plan, to determine each year the overall number of awards and the individual awards to Executive Directors and senior management;
- ▶ determine the level of any payment made to the Executive Directors or members of senior management by way of compensation for, or otherwise in connection with, loss of office or employment;
- ▶ to review and approve Group-wide salary increases; and
- ▶ to review any major changes in employee benefits structures throughout the Group.

Main activities in 2019

- ▶ Harmonisation of the terms of employment and review of employee benefit structures.
- ▶ Benchmarking of Executive Director and senior management total remuneration and Non-executive Directors' remuneration.
- ▶ Review of salary and grading structures across the Group.
- ▶ Gender pay gap reporting.

As Chair of the Remuneration Committee, I am pleased to present the Directors' Remuneration Report (the Report) for the financial year ended 31 December 2019. The report has been prepared by the Committee and approved by the Board of Directors (the Board).

The Committee endeavours to ensure transparency in respect of the Company's policies for Executive Directors and senior management remuneration and aims to provide clear reporting both on past remuneration and future policy.

The report has been arranged in the following three parts:

- ▶ the Chair's Annual Statement, summarising and explaining the major decisions on, and any substantial changes to, Executive Directors' remuneration in the year;

Main activities in 2019 continued

- ▶ the Directors' remuneration policy, which sets out the Group's forward-looking policy for Executive and Non-executive Directors and the key factors which were taken into account in setting the Executive Directors' and senior management remuneration policy; and
- ▶ the Annual Report on Remuneration, which sets out details of Executive Directors' remuneration for the financial year ended 31 December 2019. The Annual Report on Remuneration is subject to an advisory shareholder vote at the AGM on 20 May 2020.

Annual statement from the Chair of the Remuneration Committee

Remuneration outcomes for the year ended 31 December 2019

The principal aim of our remuneration policy is to ensure Executive Directors and senior management are rewarded for achieving our strategy of delivering long-term value to our stakeholders, including our shareholders. The importance of aligning our remuneration arrangements with the Company's strategic priorities continues to play a crucial role in the Committee's decision making. The Company's remuneration policy is designed to ensure that the Executive Directors and senior management are fairly and responsibly rewarded for their individual contribution to the overall long-term performance of the Company, in a manner that ensures that the Company is able to attract, motivate and retain Executives of the quality necessary to ensure the success and sustainability of the Company.

The remuneration of Executive Directors and senior management is structured to ensure that:

- ▶ the fixed elements of pay, salary, pension and benefits are benchmarked against comparable companies of similar size and complexity;
- ▶ Executive Directors and senior management are entitled to both short-term and long-term incentives, in form of cash bonuses and share options. Both the short-term and long-term incentives are underpinned by performance criteria linked to the Group's performance; and
- ▶ remuneration rewards the meeting of specific KPIs which include, inter alia, the delivery of long-term value to shareholders, a safe operating environment, compliance with relevant health and safety policies and outstanding service to customers.

In determining the remuneration of Executive Directors, the Remuneration Committee also ensures that remuneration arrangements are:

- ▶ transparent and measurable;
- ▶ not excessive, thus mitigating the reputational and behavioural risks that could arise from target-based incentive plans; and
- ▶ aligned to our culture, driving behaviours consistent with our core values.

Tim Mortlock assumed the newly created position of Chief Operating Officer with effect from 17 September 2019. Tim Mortlock was appointed with the same base salary as the Chief Financial Officer, David Thompson. On 29 May 2019 Ruth Leak was appointed as a Non-executive Director and took over as the Chair of the Information Technology Committee of the Board. This report reflects their remuneration and rewards from the date of their respective appointments.

The remuneration policy includes a discretionary annual bonus designed to incentivise Executive Directors to achieve demanding annual targets relating to the Company's financial and operational performance, and strategic and personal objectives. The Group's remuneration policies are weighted based on financial performance, operational and strategic objectives and the Committee continues to be of the view that the policies support the objectives of the Group and are aligned with our shareholders and the wider workforce.

As set out in detail on pages 29 to 33, the Group has achieved a solid trading performance in 2019, with Executives and senior management dealing with difficult operating conditions caused by both wider industry issues and technical issues, primarily rooted in Radio Frequency interference of smart meters in the North of England and Scotland. Notwithstanding these challenges, the Group has continued to grow annualised recurring revenue, our key financial metric, ahead of expectations. As at 31 December 2019, the Group had over 3.7 million metering and data assets under management of which over 1.2 million are domestic smart meters. Most importantly, there have been no significant health and safety incidents in the year with a core priority of the Group to provide a safe and secure operating environment for all our staff (see pages 42 to 43 for details).

In determining the levels of variable remuneration, the Committee has been mindful of the backdrop of a challenging operational year but has recognised the continuing focus of the Executive Directors to ensure a strong order book, engineering expertise and financial capability to grow the business over the medium term. The bonus KPIs were met in part and the Committee approved bonus payments, in principle, for the Executive Directors as follows: Alan Foy, 60% of the maximum, 59.8% of the maximum for David Thompson and 59.5% for Tim Mortlock.

In the opinion of the Committee, the annual bonus appropriately reflected overall performance; however, given the difficult operating conditions throughout the year, which have resulted in reduced profits, and the Group's continued focus on cost discipline, the Executive Directors took the decision to forgo their annual bonus to reinforce their strong commitment to the business and employees at this time. The decision by the Executive Directors to forgo the annual bonus was deemed appropriate by the Remuneration Committee.

Harmonisation of our staff policies and procedures was an area of focus in 2019, with a successful Group-wide consultation project to standardise our terms of employment and a benchmarking exercise of Executive Directors' salaries and Non-executive Directors' remuneration.

As part of its review of Executive Directors' salaries, the Committee took account of the pay policies in place across the wider business. This included considering the structure of remuneration at each level of the business to ensure there is a strong rationale for how salary packages evolve across the different levels of the organisation. The Remuneration Committee attaches considerable importance to the culture in our business to ensure we offer competitive reward frameworks that have solid foundations and are affordable, transparent and fair to all employees. The Committee felt it was appropriate to develop an approach to reward that reflects "one SMS" and supports the development of our people and future business growth. The Group's objective is to conduct external market benchmarking, design a single grading structure, create clear and transparent pay structures and develop a pay model to aid implementation and decision making. A Group-wide reward project is underway with the engagement of an external consultant, Verditer Consulting Limited, to support this project and provide guidance and benchmarking advice. The Committee will work to ensure that its remuneration policy and frameworks remain aligned with the business and its shareholders and are an effective reward mechanism for all employees.

The Committee continued to focus on the Company's reporting in relation to gender pay gap and continued to promote equality and diversity amongst our employees. Full gender pay gap reporting was achieved in 2019 with further details being found on the Company's website.

In addition, as disclosed on page 41, we have continued our journey towards becoming an Employer of Choice and we are proud to confirm that, as of 1 January 2019, the Group was a Living Wage employer. As part of our wider workforce engagement, we have improved our communication around Group activity, the future direction of the organisation and business performance in general. We now have formal business update sessions in our locations every quarter, delivered by our Executive team. As part of the Board's aim to continue to improve employee engagement, it is the intention for Committee members to attend a selection of employee forums. Such engagement will encompass matters wider than simply pay arrangements, with the outputs being reported direct to the nominated Non-executive Director, currently the Chair of the Remuneration Committee, and thence to the Board. This will assist the Remuneration Committee (and the Board) and help in providing a first-hand insight into our people's priorities. These views will add further colour to the context in which the Remuneration Committee's decision making occurs and will lead to tangible and measurable improvements in areas that matter most to our people.

External advice

During the year, the Committee engaged FIT Remuneration Consultants to assist with benchmarking Executive Directors' and Non-executive Directors' remuneration. The Committee also engaged Verditer Consulting Limited to assist with a revised structure of total remuneration for Executives and senior management. Both Verditer Consulting and FIT Remuneration Consultants are considered to be independent of both the Board and each of the Executive and Non-executive Directors. They have not provided any other services to the Directors.

The Committee unanimously recommends that shareholders vote to accept the Annual Report on Remuneration.

On behalf of the Board

MIRIAM GREENWOOD
Chair of the Remuneration Committee
17 March 2020

Directors' remuneration policy (the Policy)

This section contains details of the Policy as prepared by the Committee. The Policy encompasses all remuneration in respect of Executive Directors and Non-executive Directors.

The Policy will be displayed on the Group's website (www.sms-plc.com) within the Annual Report, under the Investor Relations section.

The objective of the Policy is to ensure that the overall remuneration of Executive Directors is aligned with the performance and objectives of the Group and preserves an appropriate balance of growth and shareholder value.

Executive Directors' remuneration

The main components of the Policy for the year ended 31 December 2019 and the linkage to and support for the Company's business strategy are summarised below:

Base salary	Benefits	Pension
Purpose and link to strategy	Purpose and link to strategy	Purpose and link to strategy
To be set at a level which is sufficiently competitive to recruit and retain individuals of the appropriate calibre to deliver the Company's strategy and which takes into account the Executives' experience and personal contribution to the Company's strategy.	To complement base salary by providing market competitive benefits to attract and retain Executives.	To provide retirement benefits which, when taken together with other elements of the remuneration package, will enable the Company to attract and retain Executives.
Operation	Operation	Operation
Salaries are typically reviewed annually, with any changes effective from 1 January. The review takes into account: <ul style="list-style-type: none"> ▶ Company performance; ▶ the scope of role, experience and performance of the individual Director; and ▶ average workforce salary adjustments within the Company. Salaries are benchmarked from time to time against comparable roles at companies of a similar size and complexity.	Reviewed from time to time to ensure that benefits when taken together with other elements of remuneration remain market competitive.	The Executive Directors (together with all other eligible staff) are able to participate in the Company's defined contribution (money purchase) pension scheme.
Potential remuneration	Potential remuneration	Potential remuneration
Increases are normally in line with inflation and other employees, or to ensure that base salaries properly reflect the size, complexity and growth rate of the Company. The Executives' base salary was reviewed on 1 January 2019 and increased for inflation in line with other employees. No inflationary increase has been awarded to Executive Directors on 1 January 2020 which is in line with other employees of the business.	The cost of providing these benefits varies year on year depending on the schemes' premiums. The Remuneration Committee monitors the overall cost of the benefits package.	The Company contributes a maximum of 5% of salary.
Performance metrics	Performance metrics	Performance metrics
n/a	n/a	n/a

Annual bonus	Individual cash bonus
Purpose and link to strategy	Purpose and link to strategy
To incentivise the achievement of the delivery of the business strategy and annual targets.	Only paid to recognise an exceptional contribution to a discrete project outside the ordinary course of business requiring the Executive Director to commit time and effort significantly over and above their normal duties.
Operation	Operation
The Executive Directors (together with the senior management team) participate in a discretionary, annual, performance related bonus scheme. Targets are set at the beginning of each year based on the recommendations of the Remuneration Committee. Bonuses are paid in cash based on the audited financial results.	Bonus to be paid at the discretion of the Remuneration Committee and based on the formal recommendation of the Chairman.
Potential remuneration	Potential remuneration
For the Executive Directors, the maximum potential bonus is 100% of annual base salary.	Maximum potential bonus at the discretion of the Remuneration Committee.
Performance metrics	Performance metrics
The annual bonus is based on three weighted areas covering financial performance, operational and strategic objectives. All three areas encompass business and personal elements. Performance measures under each area are determined annually and the Committee is able to adjust the weighting of the areas annually based on prevailing business needs. For the year ended 2019 the weighting of the annual bonus award was based on 45% for financial performance, 30% for operational objectives and 25% for strategic objectives. For the year ended 2019, the objectives included targets for underlying profit before tax, index-linked recurring revenues and no health and safety incidences.	Committee to evaluate the contribution of the Executive Director to any project outside the ordinary course of the business, with a particular emphasis on the level of commitment made by the Executive Director.

Non-executive Directors

The remuneration of the Non-executive Directors, including the Chairman, is determined by the Executive Directors after external benchmarking. Non-executive Directors and the Chairman do not participate in incentive arrangements or receive other remuneration in addition to their fees.

Each of the Non-executive Directors has a letter of appointment stating their annual fee and that their appointment is for a term of three years. Their appointment may be terminated on three months' written notice at any time.

Fees
Purpose and link to strategy
To attract and retain Non-executive Directors with an appropriate degree of skills, experience, independence and knowledge of the Company and its business.
Operation
Fee levels for Non-executive Directors are generally reviewed by the Board annually. Remuneration comprises an annual fee for acting as a Non-executive Director and serving as a member of any Committees. Additional fees are paid in respect of service as Chairman of a Committee or as Senior Independent Director. When reviewing fees, reference is made to fees for the same comparator group as used for Executive Directors, information provided by a number of remuneration surveys, the extent of the duties performed and the size of the Company.
Potential remuneration
Any fee increases are applied in line with the outcome of the annual review. Non-executive Directors received a cost of living increase to their fees as at 1 January 2019.
Performance metrics
n/a

Directors' remuneration policy (the Policy) continued

Service contracts and policy on payment for loss of office

It is the Company's policy to provide six months' notice for termination of employment for Executive Directors, to be given by either party. The Company's policy is to limit severance payments on termination to pre-established contractual arrangements; if the Company believes it appropriate to protect its interests, it may also make additional payments in exchange for non-compete/non-solicitation terms which are above and beyond those in the Director's contract of employment. Typically, these will serve to extend the non-compete period for up to nine months from the date of termination. The Committee has discretion to contribute towards outplacement services and the legal fees for any departing Director to the extent it considers appropriate. Under normal circumstances, the Company may terminate the employment of an Executive Director by making a payment in lieu of notice equivalent to basic salary and benefits for the notice period at the rate current at the date of termination. In case of gross misconduct, a provision is included in the Executive's contract for immediate dismissal with no compensation payable.

The terms applied to the Executive Directors' share options are consistent with those applied to all option holders under the rules of the Group's Unapproved Share Option Plan (the Plan). Options are subject to a five-year service condition, which commences from the grant date of the first tranche. The Plan rules contain provisions for good and bad leavers and an Executive Director would only retain rights to exercise share options, in respect of shares for which performance conditions have been met at the leaving date, where they are deemed a good leaver. There is no entitlement to compensation or damages for any loss or potential loss which may be suffered by reason of being or becoming unable to exercise an option as a consequence of loss of office or employment.

There were no resignations of Executive Directors during the year.

Treatment of annual bonus on termination of employment

The Committee has discretion to determine that in the event an Executive Director leaves the Company, bonus payments may be paid once performance has been measured and on a pro-rated basis for the time spent in active employment with the Company.

Shareholder views

The Committee welcomes the views of shareholders in respect of pay policy as well as those views expressed on behalf of shareholders by their respective proxy advisers. The Committee documents all remuneration related comments made at the Company's AGM and feedback received during consultation with shareholders throughout the year. Any feedback received is fully considered by the Committee and amendments may be made to the remuneration policy where thought necessary.

Discretion of the Committee

The Committee has discretion in various areas of policy as set out in this report. The Committee may also exercise discretion under the rules of the Plan approved by shareholders, as set out in those rules. In addition, the Committee has the discretion to amend the implementation of the Policy with regard to minor or administrative matters where it would be, in the opinion of the Committee, disproportionate to seek or await shareholder approval.

Differences in remuneration policy for all employees

All employees of the Group are entitled to base salary and benefits. The Group also operates a pension plan for employees which it operates in line with local market practice. Some employees are entitled to participate in an annual discretionary bonus scheme.

Annual report on remuneration

Directors' remuneration emoluments for the financial year ended 31 December 2019

	Fees/ basic salary £	Annual bonus £	Pension contribution £	Benefits in kind £	2019 Total £	2018 Total £
Executive						
A H Foy	357,869	—	—	19,228	377,097	663,381
D Thompson	221,037	—	8,762	1,212	231,011	411,137
T Mortlock ¹	64,592	—	2,584	2,278	69,454	—
Non-executive						
W MacDiarmid	91,800	—	—	—	91,800	90,000
M Greenwood	45,900	—	—	—	45,900	45,000
G Bissett	45,900	—	—	—	45,900	45,000
R Leak ²	26,775	—	—	—	26,775	—
K Olsen ³	—	—	—	—	—	34,788
Total	853,873	—	11,346	22,718	887,937	1,289,306

1 T Mortlock's remuneration for 2019 is from the date of appointment as a Director, 17 September 2019.

2 R Leak's remuneration for 2019 is from the date of appointment as a Director, 29 May 2019.

3 K Olsen resigned as a Director on 17 October 2018.

With the exception of the bonus, which is discretionary as detailed in the remuneration policy on page 67, all other elements of Directors' remuneration is fixed.

Details of each of the elements included in the table above are as follows:

Base salary

Base salary increases across the Group are effective from 1 January each year. Both Executive and Non-executive Directors received a cost of living increase as at 1 January 2019. The base salary numbers shown in the table therefore include twelve months' pay based on the Director's salary from 1 January 2019 with the exception of Tim Mortlock and Ruth Leak with figures disclosed from the date of their respective appointments.

Pension contributions

The Chief Executive Officer does not participate in the scheme. An amount is paid to the Eco Retirement Benefit Scheme, of which the Chief Executive Officer is a trustee. See note 21 (d) to the financial statements for further details.

A contribution of up to 5% per annum of base salary is paid into the scheme, by the Company, on behalf of the Chief Financial Officer and Chief Operating Officer.

Bonus

The awards were calculated as described below:

Awards based on financial measures (45% of total award)

Underlying profit is used for the purposes of the bonus, which excludes exceptional items and amortisation of intangibles.

Awards based on operational objectives (30% of total award)

Each of the Executive Directors has individual operational objectives, including health and safety, which is a number one priority throughout the Group.

Awards based on strategic objectives (25% of total award)

Each of the Executive Directors has individual strategic objectives with 25% of the maximum incentive opportunity linked to performance against these objectives.

The Committee may use discretion to adjust payments where necessary.

With the support of the Committee, the Executives forgo their annual bonus in 2019, as detailed on page 64.

Benefits in kind

The Company pays for private healthcare for each Executive Director and their immediate family. The Company provides a company car allowance for the Chief Executive Officer and Chief Operating Officer. The Executive Directors also currently participate in the Company's life assurance scheme.

Directors' interests

The Directors who held office at 31 December 2019 had the following interests in the shares of the Company:

	Ordinary shares	
	2019 £0.01 each	2018 £0.01 each
Executive		
A H Foy ¹	5,380,608	5,380,608
D Thompson	1,335	1,335
T Mortlock	5,263	—
Non-executive		
M Greenwood	16,661	16,661
W MacDiarmid ²	5,923	5,923
G Bissett	5,300	5,300
Total	5,415,090	5,409,827

1 Includes 900,000 ordinary shares held by The Metis Trust, of which A H Foy is a trustee but not a beneficiary.

2 This includes shares held by a connected person.

Annual report on remuneration continued

Directors' share options

Aggregate emoluments disclosed above do not include any amounts for the value of options to acquire ordinary shares in the Company granted to or held by the Directors. Details of options for Directors who served during the year are as follows:

	Type	Number of shares under option	Exercise price	Date of grant	Earliest date exercisable
Executive					
A H Foy	Unapproved	500,000 ¹	700p	13/07/18	01/01/23
D Thompson	Unapproved	100,000	529p	01/09/16	01/09/21
	Unapproved	300,000 ²	700p	13/07/18	01/01/23
T Mortlock	Unapproved	133,250	350p	12/11/14	12/11/19
	Unapproved	333,333 ³	700p	13/07/18	01/01/23

1 The number of shares under option of 500,000 comprises five annual tranches of which 200,000, being the first and second tranches, had been awarded as at 31 December 2019.

2 The number of shares under option of 300,000 comprises five annual tranches of which 120,000, being the first and second tranches, had been awarded as at 31 December 2019.

3 The number of shares under option of 333,333 comprises five annual tranches of which 133,334, being the first and second tranches, had been awarded as at 31 December 2019.

The share price at 31 December 2019 was 565p. The range in the period 1 January to 31 December 2019 was 310p to 665p.

Share options are awarded in annual tranches. Each tranche is measured by reference to a distinct, annual performance period and is subject to a market capitalisation target, set up front, and non-market performance criteria based on financial targets and individual objectives, which are set at the beginning of the corresponding performance period. The options are subject to a vesting period of five years from the grant date of the first tranche. There is the ability to retrospectively vest tranches where a missed market capitalisation target is subsequently met in future years and the Remuneration Committee has an element of discretion in relation to the vesting of awards.

Further details of share options granted by the Company at 31 December 2019 are given in note 23.

The Directors submit their Annual Report on the affairs of the Group together with the financial statements and Auditor's Report for the year ended 31 December 2019.

Principal activities

SMS plc is the ultimate parent company of the Group and trades principally through its subsidiary undertakings. The Group is a major smart metering and energy services company. Subsidiaries of the Company are listed on page 113 of this Annual Report.

Information incorporated by reference

The Strategic Report and the Corporate Governance Report are incorporated by reference into this Directors' Report and should be read as part of this report.

The Strategic Report can be found on pages 1 to 48 and contains details of the Group's business model and strategic priorities. The purpose of the Strategic Report is to enable shareholders to assess how the Directors have performed their duty under section 172 of the Companies Act 2006 (the Act).

An indication of the likely future developments in the business of the Company (and its subsidiaries) is also included in the Strategic Report on pages 1 to 48, which satisfies the reporting requirements of section 414C(11) of the Companies Act 2016.

Directors

The Directors who served throughout the year, except as noted, were as follows:

Name of Director	Board title	Date of appointment
W MacDiarmid	Non-executive Director and Chairman	26 May 2016
A H Foy	Chief Executive Officer	24 December 2007
D Thompson	Chief Financial Officer	11 September 2017
T Mortlock	Chief Operating Officer	17 September 2019
M Greenwood	Non-executive Director	3 February 2014
G Bissett	Non-executive Director	1 June 2016
R Leak	Non-executive Director	29 May 2019

Political contributions

No political contributions were made during the year (2018: £Nil).

Substantial shareholdings

On 3 February 2020, the Company had been notified, in accordance with sections 791 to 828 of the Companies Act, of the following interests in the ordinary share capital of the Company:

Name of holder	Number	% held
Liontrust Asset Management	14,514,995	12.86
PrimeStone Capital LLP	9,582,959	8.49
Merian Global Investors (UK) Ltd.	7,427,170	6.58
Fidelity Investments	6,057,281	5.37
River & Mercantile Asset Management LLP	5,629,497	4.99
Mr Steve P Timoney	5,644,344	5.00
Hargreave Hale Ltd	5,400,000	4.79
Mr Alan Foy	4,480,608	3.97
Brooks Macdonald Asset Management	2,948,187	2.61
Canaccord Genuity Wealth Management (CI)	2,902,694	2.57
Westray Capital Management LLC	2,847,813	2.52
Soros Fund Management LLC	2,381,563	2.11

Share capital

The Company's issued share capital comprises ordinary shares of 0.01p each which are listed on AIM, a market operated by the London Stock Exchange (AIM: SMS.L). As at 31 December 2019, the issued share capital of the Company was £1,128,111 comprising 112,811,122 ordinary shares of £0.01 each.

Details of the issued share capital of the Company, together with movements in the issued share capital during the year, can be found in note 22 to the financial statements. All the information detailed in note 22 forms part of this Directors' Report and is incorporated into it by reference.

Share capital continued

The Company was authorised at the 2018 AGM to allot shares or grant rights to or subscribe for or convert any security into shares in the Company up to a nominal amount of £375,618. This aligns with the institutional investor guideline recommended figure of an amount equal to one-third of the total issued share capital. This authority is valid for a period expiring five years from the date the resolution was approved at the 2018 AGM; however, this authority is revised on an annual basis at each AGM during which the previous year's resolution is generally superseded.

Additionally, the Company was authorised at the 2018 AGM to make market purchases of its own shares subject to the condition that the number of ordinary shares repurchased shall not exceed 5% of the issued share capital of the Company. This authority shall expire on the earlier of the next AGM, to be held in Summer 2020, or the date falling 15 months after the date on which the resolution was passed at the 2018 AGM.

Dividends

The Directors consider the Group's capital structure and dividend policy ahead of announcing interim and year-end results and do so in the context of its ability to continue as a going concern, to meet its debt obligations, to continue investment in growth and to enhance shareholder value.

The dividend policy is influenced by several principal risks as identified on pages 46 to 48 that could have a negative impact on the performance of the Group. The risks that could specifically have an adverse impact on the dividend policy include our working capital management, critical supplier dependency and loss of required accreditations, although we believe we can sufficiently mitigate those risks as outlined on pages 46 to 48.

In determining the level of dividend in any year the Directors follow the dividend policy and also consider the distributable reserves in the parent company, availability of cash resources, dividend and operational cash flow cover together with future cash commitments and investment plans in line with the Group's overall strategy. The Directors' intentions for future dividend policy are explained in the Chairman's Statement on pages 6 to 8. Further details are provided in note 8 to the financial statements regarding the level of distributable reserves in the parent company at 31 December 2019.

The Directors recommend the payment of a second interim dividend of 4.58p per ordinary share and no final dividend (2018: no second interim dividend, final dividend of 3.98p). The second interim dividend will be payable on 4 June 2020 to shareholders on the Company's Register of Members as at the close of business on 24 April 2020. The shares will be quoted as ex-dividend on 23 April 2020. The second interim dividend and final dividend, together with the first interim dividend of 2.30p per ordinary share (2018: 2.20p) paid on 22 November 2019, makes a total dividend of 6.88p per ordinary share for the 2019 financial year (2018: 5.98p).

Financial instruments

Details of the use of financial instruments and financial risk management are included in note 18 of the notes to the accounts contained in this Annual Report and Accounts 2019, which is incorporated by reference into this Directors' Report.

Employees

The Group places considerable value on the involvement of its employees and is firmly committed to the continuation and strengthening of communication lines with all its employees. The Group's policy of operating through autonomous subsidiaries helps ensure close communication and sharing of information with employees on matters likely to affect their interests. In addition, the workforce is kept up to date on the various financial and economic factors affecting the performance of the Group.

The internal communications team issues monthly newsletters, providing employees with information on key events and activities undertaken by the Group, alongside industry-wide updates such as the progress of the UK smart meter rollout. During the 2019 financial year, this has included items such as the acquisition of Solo Energy, the deployment of new technology systems, successful achievements with regard to accreditations, regulatory audits and other industry awards, and various other internal projects deemed significant enough for Company-wide communication. Periodic updates on Group performance are also released to the wider workforce, typically following the announcement of the interim and annual financial results.

Business update sessions are now delivered in our locations, every quarter, by the Executive Management Team.

The Group seeks to engage with employees for views on matters affecting them, through several channels such as employee workshops, written feedback and drop-in sessions. Our Stakeholder Engagement Report on pages 18 to 22 provides examples of projects delivered during the year, where an open dialogue was facilitated with the workforce, and further details can be found in the Sustainability Report on pages 38 to 41.

The involvement of employees in the Company's performance is encouraged through its Share Incentive Plan, which is open to all qualifying employees at all levels. An HMRC-approved, tax efficient plan, this supports the engagement and retention of our workforce by providing returns that are inherently driven by the performance of the Company. The terms of this arrangement are detailed further below. In addition, share options are granted at the discretion of the Board, typically to management-level staff. Further details can be found in note 23 to the financial statements, which is incorporated by reference into this report.

The Group operates an equal opportunities, diversity and inclusion policy, detailed further on page 40.

It is the policy of the Group to support the employment of people with disabilities wherever practicable and to ensure, as far as possible, that training, career development and promotion opportunities are available to all employees and as such SMS is Disability Confident Committed.

Other stakeholders

In compliance with the Companies (Miscellaneous Reporting) Regulations 2018 (MRR), issued in July 2018 for years beginning on or after 1 January 2019, the Board recognises its responsibility to understand and consider stakeholder views as part of its decision-making process and remains committed to fostering effective business relationships. More information on how the Board considers stakeholders, including on the principal decisions taken by the Company during the financial year, can be found in the Strategic Report on pages 18 to 22. Details of how the Board engaged with shareholders during the year are on pages 57 to 58.

Share Incentive Plan (SIP)

The SIP is HMRC approved and is open to all qualifying employees, including Executive Directors.

The Partnership Share element provides that for every share a participant purchases in the Company, up to a current maximum contribution of £1,800 per year, the Company will purchase one Matching Share. The Matching Shares purchased are held in trust in the name of the individual. Dividends received on shares held in the SIP are reinvested to acquire Matching Shares at their market value.

There are various rules as to the period of time that the shares must be held in trust but after five years the shares can be released tax free to the participant.

Under the terms of this scheme, unless they are a good leaver, the Matching Shares will be forfeited if the participant leaves the employment of the Company within three years of the award.

During the year, the Company purchased 67,220 of its own shares (2018: 36,137) from the market for the purpose of satisfying its Matching Share obligations under the SIP. The nominal value of the shares purchased was £672 (2018: £361) and the aggregate amount of consideration paid was £0.3m (2018: £0.2m).

Research and development

The main research and development activities relate to IT systems development to facilitate the metering and installations business. In addition, the Group continues to invest in future technologies related to decarbonisation and energy efficiency.

Post balance sheet events

Relevant post balance sheet events requiring disclosure are included in note 28 to the accounts.

Director qualifying indemnity provisions

As permitted by the Companies Act 2006, the Company purchases and maintains Directors' and officers' insurance cover against certain legal liabilities and costs incurred by the Directors and officers of the Group companies in the performance of their duties. The Company has also granted an indemnity to each of its Directors in relation to the Directors' exercise of their powers, duties and responsibilities as Directors of the Company, the terms of which are in accordance with the Companies Act 2006.

Directors' statement as to disclosure of information to auditor

Each of the Directors at the date of approval of this Annual Report confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006. Ernst & Young LLP has expressed its willingness to continue in office as auditor and a resolution to re-appoint Ernst & Young LLP will be proposed at the forthcoming AGM.

Going concern

After making enquiries, we, the Directors, have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. We therefore continue to adopt the going concern basis in preparing the financial statements. The basis on which this conclusion has been reached is set out on page 87 which is incorporated by reference here.

Approved by the Board of Directors on 17 March 2020 and signed on its behalf below.

On behalf of the Board

DAVID THOMPSON
Chief Financial Officer
17 March 2020

In the preparation of financial statements

The Directors are responsible for preparing the Directors' Report, the Strategic Report, the Directors' Remuneration Report, the separate Corporate Governance Statement and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Company financial statements for each financial year. The Directors are required by the AIM Rules of the London Stock Exchange to prepare Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) and have elected under company law to prepare the Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 The Financial Reporting Standard Applicable in the UK and Republic of Ireland.

The Group financial statements are required by law and IFRSs adopted by the EU to present fairly the financial position and performance of the Group; the Companies Act 2006 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period.

In preparing each of the Group and Company financial statements, the Directors are required to:

- ▶ select suitable accounting policies and then apply them consistently;
- ▶ make judgements and accounting estimates that are reasonable;
- ▶ for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU and, for the Company financial statements, state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the Company financial statements; and
- ▶ prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Smart Metering Systems plc website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

This responsibility statement was approved by the Board of Directors on 17 March 2020 and signed on its behalf below.

By order of the Board

CRAIG MCGINN

Company Secretary and General Counsel

17 March 2020

To the members of Smart Metering Systems plc

Opinion

In our opinion:

- ▶ Smart Metering Systems plc's Group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2019 and of the Group's profit for the year then ended;
- ▶ the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- ▶ the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- ▶ the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Smart Metering Systems plc which comprise:

Group	Parent company
Consolidated statement of financial position as at 31 December 2019	Balance sheet as at 31 December 2019
Consolidated income statement and consolidated statement of comprehensive for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 8 to the financial statements including a summary of significant accounting policies
Consolidated statement of cash flows for the year then ended	
Related notes 1 to 29 to the financial statements, including a summary of significant accounting policies	

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- ▶ the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- ▶ the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none"> ▶ Identification of indicators of impairment of the meter asset portfolio in accordance with IAS 36 and assumptions applied in determining the carrying value of the portfolio of meter assets if indicators are present. ▶ Appropriateness of capitalisation of overheads and other expenses within the total of costs capitalised within meter assets.
Audit scope	<ul style="list-style-type: none"> ▶ We performed an audit of the complete financial information of three components and audit procedures on specific balances for a further seven components. ▶ The components where we performed full or specific audit procedures accounted for 100% of pre-tax profit before exceptional items (our audit testing covers 100% of exceptional items), 100% of Revenue and 99% of Total assets.
Materiality	<ul style="list-style-type: none"> ▶ Overall Group materiality of £0.7m which represents 5% of adjusted pre-tax profits before exceptional items.

To the members of Smart Metering Systems plc

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Identification of indicators of impairment of the meter asset portfolio in accordance with IAS 36 and assumptions applied in determining the carrying value of the portfolio of meter assets if impairment indicators are present (£399m value of risk, PY comparative £350m)</p>	<p>i/ Traditional meters</p> <p>We obtained management's impairment assessment which concluded that there are indicators present due to the declining nature of the traditional meter portfolio.</p>	<p>Based on the audit procedures performed in relation to the meter portfolio, we consider the year-end carrying value to be appropriate.</p>
<p><i>Refer to the Audit Committee Report (page 61); Accounting policies (page 92); and Note 10 of the Consolidated Financial Statements</i></p>	<p>We identified controls designed by management to determine the appropriateness of the assumptions included within the impairment model.</p>	<p>In relation to SMETS1 meters, until the enrolment and adoption programme is completed, there may be removal of further meters which would represent a small proportion of the total portfolio of meters. We do not consider this to represent an impairment risk to the wider SMETS1 portfolio.</p>
<p>i/ Traditional meters</p> <p>An impairment charge of £5.6m was recognised in 2018 in relation to the traditional meter portfolio driven by the accelerated rate which the meters were removed from the wall and the churn in customers from a contracted to non-contracted position reducing expected future termination income. On consideration of the declining nature of the traditional meter portfolio, a value in use impairment assessment is prepared as at each reporting date.</p>	<p>We conducted substantive audit procedures and did not test controls.</p>	<p>We consider the disclosures made around the traditional meter portfolio valuation to be adequate to explain the estimates made by management and the sensitivities should events differ from those assumed within the calculation.</p>
<p>The impairment assessment as at 31 December 2019 indicated that there remained headroom and no further impairment charge should be recognised in relation to the traditional meter portfolio.</p> <p>Management concluded that it would not be appropriate to recognise a reversal of the historical impairment charge on consideration of the declining nature of the portfolio and the components that triggered the impairment last year, remain prevalent in the current year.</p>	<p>We audited management's impairment calculation relating to traditional meters by:</p> <ul style="list-style-type: none"> ▶ challenging the assumptions forming the basis of the cash flows being the profile of removal of meters from the wall; the recoverability of termination income for the meters remaining on the wall; the expected churn in customers between energy suppliers; the recurring rental expected to be earned on the existing portfolio and termination income earned; and the expected inflationary increase; ▶ we assessed the discount rate used in the impairment model with the assistance of EY's valuation experts; ▶ we performed sensitivity testing of the assumptions considered key to determine if there remained headroom; ▶ we reconciled the carrying value of the traditional meter portfolio to our fixed asset testing; and ▶ we tested the mathematical accuracy of the calculation. <p>We considered the appropriateness of the related disclosures in the Group financial statements. We assessed the appropriateness of classifying the loss on disposal of meters removed from the wall as an exceptional item given the declining nature of this traditional meter portfolio.</p>	
<p>ii/ Other meters – smart, industrial and commercial (I&C)</p>	<p>ii/ Other meters – smart, industrial and commercial</p>	
<p>Management prepared an assessment of potential impairment indicators in relation to the smart and I&C meter portfolio. This included consideration of the temporary industry transitional issues experienced with certain SMETS 1 meters.</p> <p>Management's assessment also included factors internal to the business.</p>	<p>We obtained management's impairment assessment which concluded there were no indicators of impairment on other meters.</p> <p>We identified controls designed by management in relation to their impairment assessment.</p> <p>We conducted substantive audit procedures and did not test controls.</p> <p>We challenged management on the potential impairment indicators identified. Our procedures included verifying assumptions to independent supporting evidence.</p>	

Key audit matters continued

Risk

Our response to the risk

Key observations communicated to the Audit Committee

ii/ Other meters – smart, industrial and commercial continued

Further, we performed procedures to independently identify any contradictory evidence of potential impairment indicators which included research of publicly available industry information and consideration of our audit work in relation to fixed assets.

We challenged management over the losses arising on the SMETS1 meters removed from the wall during the year and whether this indicated a potential impairment indicator across the wider portfolio of SMETS1 meters.

We obtained evidence that indicated that the meters removed earlier in the year arose due to the uncertainty surrounding the transitional issues. We confirmed that the Data Communications Company has issued a timeline for the Enrolment and Adoption programme which brought clarity to the technical issues that have been encountered to date and consideration that the meters removed from the wall can be re-used.

The primary team performed full scope audit procedures over this risk area in two locations, which covered 100% of the risk amount.

Appropriateness of capitalisation of overheads and other expenses within the total of costs capitalised within meter assets (£39.7m, PY comparative £25.4m)

Refer to Audit Committee Report (page 61); Accounting policies (page 88) and note 10 in the Consolidated Financial Statements.

As at 31 December 2019, the Group carried total meter assets amounting to £399m (2018: £350m). This includes internal operational costs that have been capitalised in the current year.

As a result of the UK government target to replace traditional domestic meters with smart meters, the Group has incurred significant capital expenditure increasing the number of smart meters under management.

A significant proportion of the Group's smart meters are fitted by its in-house engineering team.

The significant risk relates to the appropriateness of the judgements made by management when assessing the appropriate categories and proportion of direct costs of installation, overheads and other expenses directly attributable to the installation of each meter.

We identified controls designed by management to determine the categories and proportion of direct costs of installation, overheads and other expenses directly attributable to bringing the meter assets into use by the Group's in-house engineering teams and ensured these had been implemented.

We evaluated the judgement applied by management to assess the appropriate categories and proportion of direct costs of installation, overheads and other expenses directly attributable to installation of meter assets. This included:

- ▶ assessment of the capitalisation methodology applied and testing of the mathematical integrity of the model;
- ▶ testing of the time recording data utilised to determine the proportion of engineer's time spent installing;
- ▶ agreement of the costs to the audited CH4 trial balance; and
- ▶ on a sample basis we tested those costs capitalised to ensure they related to directly attributable costs of fitting the meter. Costs that did not relate to the meter fitting were excluded. This included inefficiencies in meter fitting, time spent on training and time spent on transactional work.

We benchmarked the average installation cost capitalised to contracted third party installation costs to assess the reasonableness of the amount capitalised.

We performed full and specific scope audit procedures over this risk area in one location, which covered 100% of the risk amount.

Based on the results of our audit procedures, we consider the amounts capitalised for meters installed by in-house engineers to be appropriate.

To the members of Smart Metering Systems plc

Key audit matters continued

In the prior year, our key audit matter in relation to the meter portfolio considered the risk of the useful economic life estimate. In the prior year, the useful economic life of traditional meters was extended from three to five years reflecting management's estimate of the period that the smart meter rollout would take. This has been validated by the Business Energy and Industrial Strategy Committee announcing in 2019 an extension to the rollout deadline.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of Group-wide controls, changes in the business environment and other factors such as recent internal audit results when assessing the level of work to be performed at each entity.

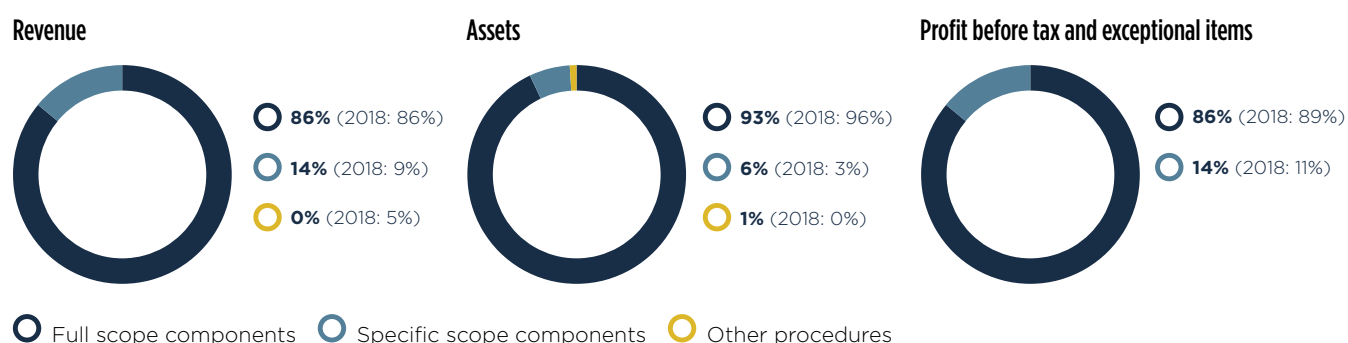
In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, of the thirteen reporting components of the Group, we selected ten components covering entities which represent the principal business units within the Group.

Of the ten components selected, we performed an audit of the complete financial information of three components ("full scope components") which were selected based on their size or risk characteristics. For the remaining seven components ("specific scope components"), we performed audit procedures on specific accounts within those components that we considered had the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile.

The reporting components where we performed audit procedures accounted for 100% (2018: 100%) of the Group's profit before tax (PBT) before exceptional items measure used to calculate materiality, 100% (2018: 95%) of the Group's Revenue and 99% (2018: 100%) of the Group's Total assets. We tested 100% of exceptional items (2018: 100%). For the current year, the full scope components contributed 86% (2018: 89%) of the Group's PBT before exceptional items used to calculate materiality, 93% (2018: 86%) of the Group's Revenue and 93% (2018: 97%) of the Group's Total assets. The specific scope component contributed 14% (2018: 11%) of the Group's PBT before exceptional items used to calculate materiality, 7% (2018: 9%) of the Group's Revenue and 6% (2018: 3%) of the Group's Total assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

The remaining three components did not contribute to the Group's Profit before tax and before exceptional items. For these components, we performed other procedures, including analytical review, testing of consolidation journals and intercompany eliminations to respond to any potential risks of material misstatement to the Group financial statements.

The charts below illustrate the coverage obtained from the work performed by our audit teams.



There were three additional entities in scope in the current year, two in relation to entities that were acquired during the year and one in relation to an entity incorporated during the year. All entities were designated as specific scope.

Involvement with component teams

All audit work performed for the purposes of the audit was undertaken by the Group audit team.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £0.7 million (2018: £1.0 million), which is 5% (2018: 5%) of pre-tax profits before £8.6million (2018: £17.1million) of exceptional items. We believe that pre-tax profits before exceptional items provides us with an appropriate materiality threshold for the users of the financial statements as the exceptional costs are considered non-recurring costs in the normal course of business.

We determined materiality for the Parent Company to be £3.7million (2018: £3.6 million), which is 2% (2018: 2%) of total equity.

During the course of our audit, we reassessed initial materiality from forecast pre-tax profits to actual pre-tax profits after exceptional items and maintained our materiality at £0.7million.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% (2018: 50%) of our planning materiality, namely £0.4million (2018: £0.5million). We have set performance materiality at this percentage due to our expectation and likelihood of misstatements taking into account the internal control environment, accounting systems and level of estimation in the financial statements.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £0.1million to £0.3million (2018: £0.1million to £0.4million).

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.04million (2018: £0.05million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the Annual Report set out on pages 1 to 74, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

To the members of Smart Metering Systems plc

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- ▶ 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; and
- ▶ the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- ▶ adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- ▶ the parent company financial statements are not in agreement with the accounting records and returns; or
- ▶ certain disclosures of Directors' remuneration specified by law are not made; or
- ▶ we have not received all the information and explanations we require for our audit.

Responsibilities of Directors

As explained more fully in the Directors' Responsibilities Statement set out on page 74, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Use of our report

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.

KEVIN WESTON (SENIOR STATUTORY AUDITOR)

for and on behalf of Ernst & Young LLP, Statutory Auditor, Glasgow

17 March 2020

Notes:

- 1 The maintenance and integrity of the Smart Metering Systems plc's website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- 2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

For the year ended 31 December 2019

	Notes	2019 Before exceptional items £'000	2019 Exceptional items ¹ £'000	2019 Total £'000	2018 Before exceptional items £'000	2018 Exceptional items £'000	2018 Total £'000
Revenue	2	114,281	—	114,281	98,492	—	98,492
Cost of sales	3	(72,217)	—	(72,217)	(51,333)	(5,612)	(56,945)
Gross profit		42,064	—	42,064	47,159	(5,612)	41,547
Administrative expenses	3	(25,514)	(8,527)	(34,041)	(21,263)	(10,529)	(31,792)
Other operating income	3	5,726	—	5,726	1,330	—	1,330
Profit from operations	3	22,276	(8,527)	13,749	27,226	(16,141)	11,085
Finance costs	5	(8,461)	(104)	(8,565)	(4,962)	(996)	(5,958)
Finance income	5	278	—	278	224	—	224
Profit before taxation		14,093	(8,631)	5,462	22,488	(17,137)	5,351
Taxation	6	(2,584)	1,119	(1,465)	(3,835)	2,948	(887)
Profit for the year attributable to owners of the parent		11,509	(7,512)	3,997	18,653	(14,189)	4,464

¹ Refer to note 3 for details of exceptional items.

The profit from operations arises from the Group's continuing operations.

Earnings per share attributable to owners of the parent during the year:

	Notes	2019	2018
Basic earnings per share (pence)	7	3.56	3.97
Diluted earnings per share (pence)	7	3.53	3.93

For the year ended 31 December 2019

	2019 Before exceptional items £'000	2019 Exceptional items £'000	2019 Total £'000	2018 Before exceptional items £'000	2018 Exceptional items £'000	2018 Total £'000
Profit for the year	11,509	(7,512)	3,997	18,653	(14,189)	4,464
Other comprehensive income¹						
Exchange differences on translation of foreign operations	(66)	—	(66)	—	—	—
Other comprehensive income for the year, net of tax	(66)	—	(66)	—	—	—
Total comprehensive income for the year attributable to owners of the parent	11,443	(7,512)	3,931	18,653	(14,189)	4,464

¹ May be reclassified to profit or loss.

As at 31 December 2019

	Notes	2019 £'000	2018 £'000
Assets			
Non-current assets			
Intangible assets	9	23,743	17,138
Property, plant and equipment	10	412,658	356,732
Investments	11	75	75
Trade and other receivables	14	232	402
Total non-current assets		436,708	374,347
Current assets			
Inventories	13	22,061	11,261
Other assets	17	—	3,105
Trade and other receivables	14	48,287	30,640
Income tax recoverable		227	292
Cash and cash equivalents	15	50,092	30,027
Total current assets		120,667	75,325
Total assets		557,375	449,672
Liabilities			
Current liabilities			
Trade and other payables	16	46,796	36,348
Lease liabilities	17	1,013	—
Other liabilities	17	—	3,105
Bank loans and overdrafts	17	1,724	172,016
Total current liabilities		49,533	211,469
Non-current liabilities			
Bank loans	17	267,536	—
Lease liabilities	17	2,950	—
Deferred tax liabilities	20	13,779	12,070
Total non-current liabilities		284,265	12,070
Total liabilities		333,798	223,539
Net assets		223,577	226,133
Equity			
Share capital	22	1,128	1,125
Share premium		160,106	158,861
Other reserve	24	9,562	9,562
Own share reserve	22	(768)	(588)
Foreign currency translation reserve		(66)	—
Retained earnings		53,615	57,173
Total equity attributable to owners of the parent		223,577	226,133

The financial statements on pages 81 to 119 were approved and authorised for issue by the Board of Directors and signed on its behalf by:

DAVID THOMPSON

Director

17 March 2020

COMPANY REGISTRATION NUMBER

SC367563

For the year ended 31 December 2019

Attributable to the owners of the parent company:	Share capital £'000	Share premium £'000	Other reserve £'000	Own share reserve £'000	Foreign currency translation reserve £'000	Retained earnings £'000	Total £'000
As at 1 January 2018	1,124	158,592	9,562	(697)	—	58,991	227,572
Total comprehensive income for the year	—	—	—	—	—	4,464	4,464
Transactions with owners in their capacity as owners							
Dividends (note 8)	—	—	—	—	—	(6,143)	(6,143)
Shares issued (note 22)	1	269	—	—	—	—	270
Movement in own shares (note 22)	—	—	—	109	—	(339)	(230)
Share-based payments (note 23)	—	—	—	—	—	1,208	1,208
Income tax effect of share options	—	—	—	—	—	(1,008)	(1,008)
As at 31 December 2018	1,125	158,861	9,562	(588)	—	57,173	226,133
Total profit for the year	—	—	—	—	—	3,997	3,997
Total other comprehensive income for the year	—	—	—	—	(66)	—	(66)
Transactions with owners in their capacity as owners							
Dividends (note 8)	—	—	—	—	—	(7,079)	(7,079)
Shares issued (note 22)	3	1,245	—	—	—	(829)	419
Movement in own shares (note 22)	—	—	—	(180)	—	(169)	(349)
Share-based payments (note 23)	—	—	—	—	—	671	671
Income tax effect of share options	—	—	—	—	—	(149)	(149)
As at 31 December 2019	1,128	160,106	9,562	(768)	(66)	53,615	223,577

See notes 23 and 24 for details of the own share reserve and other reserve.

For the year ended 31 December 2019

	2019 £'000	2018 £'000
Operating activities		
Profit before taxation	5,462	5,351
Finance costs	8,461	4,962
Finance income	(278)	(224)
Exceptional items ¹	6,326	15,426
Depreciation	35,137	21,796
Amortisation of intangibles	1,483	2,597
Share-based payment expense	603	488
Loss on disposal of property, plant and equipment	2,280	1,659
Loss on disposal of intangible assets	421	—
Movement in inventories	(10,049)	4,432
Movement in trade and other receivables	(17,503)	(5,215)
Movement in trade and other payables	9,989	(11,639)
Cash generated from operations	42,332	39,633
Income tax received	56	408
Net cash generated from operations	42,388	40,041
Investing activities		
Payment for acquisition of subsidiary, net of cash acquired	(1,027)	—
Payments to acquire property, plant and equipment	(101,698)	(132,643)
Proceeds on disposal of property, plant and equipment	6,407	4,264
Payments to acquire intangible assets	(6,936)	(5,887)
Finance income received	278	224
Net cash used in investing activities	(102,976)	(134,042)
Financing activities		
New borrowings	270,000	101,627
Borrowings repaid	(172,114)	(117,281)
Principal elements of lease payments	(1,075)	—
Finance costs paid	(9,149)	(4,815)
Net proceeds from share issue	419	270
Purchase of own shares	(349)	(230)
Dividends paid	(7,079)	(6,143)
Net cash generated from/(used in) financing activities	80,653	(26,572)
Net increase/(decrease) in cash and cash equivalents	20,065	(120,573)
Cash and cash equivalents at the beginning of the financial year	30,027	150,600
Cash and cash equivalents at the end of the financial year (note 15)	50,092	30,027

¹ Non-cash exceptional items include a £6,837,000 loss on disposal on our meter portfolio, £68,000 cost relating to deferred remuneration arising on the acquisition of a subsidiary in 2016 settled in shares in April 2019, £751,000 stock write-back for returned SMETS1 meters, £93,000 acceleration of loan arrangement fees in relation to the refinancing of the loan facility and £79,000 for non-recurring impairment charges.

In 2018, non-cash exceptional items included a £7,040,000 loss on disposal on our meter portfolio, £5,612,000 impairment on our meter portfolio, £1,653,000 traditional meters stock write down, £720,000 relating to deferred remuneration arising from the acquisition of a subsidiary in 2016 to be settled in shares, £43,000 for impairment of an investment and £358,000 acceleration of loan arrangement fees in relation to the refinancing of the loan facility.

This note provides a list of the significant accounting policies adopted in the preparation of these consolidated financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated. The consolidated financial statements of the Group for the year ended 31 December 2019 were approved and authorised for issue in accordance with a resolution of the Directors on 17 March 2020. Smart Metering Systems plc is a public limited company limited by shares and incorporated in Scotland, with its registered office at 2nd Floor, 48 St. Vincent Street, Glasgow G2 5TS. The Company's ordinary shares are traded on AIM.

Basis of preparation

The consolidated financial statements have been prepared in accordance with EU-endorsed International Financial Reporting Standards (IFRSs), IFRIC interpretations and the Companies Act 2006 applicable to companies reporting under IFRSs.

The financial statements have been prepared on a historical cost basis, modified by the revaluation of certain financial assets and financial liabilities that have been measured at fair value.

The consolidated financial statements are presented in British Pounds Sterling (£), which is Smart Metering System plc's functional and presentation currency, and all values are rounded to the nearest thousand (£'000) except where otherwise indicated.

Going concern

Management prepares budgets and forecasts on a five-year forward-looking basis. These forecasts cover operational cash flows and investment capital expenditure and are prepared based on management's estimation of installation run rates through the UK smart meter rollout.

On 21 December 2018, a new banking facility was signed, providing the business access to £420m over the next five years. The first drawdown under this new facility was on 3 January 2019, at which point the Group's obligations under the previous £280m facility of £172m were settled. These transactions were settled concurrently on a net cash basis.

Net debt amounted to £219.2m at 31 December 2019 and, at that date, undrawn facilities were £150.0m. The Group balance sheet shows consolidated net assets of £223.6m (2018: £226.1m) of which £398.7m (2018: £350.4m) relates to meter assets.

Based on the above, the Directors consider it appropriate to continue to prepare the financial statements on a going concern basis.

Basis of consolidation

The consolidated accounts of the Group include the assets, liabilities and results of the Company and subsidiary undertakings in which Smart Metering Systems plc (SMS) has a controlling interest. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has all of the following: power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee); exposure, or rights, to variable returns from its involvement with the investee; and the ability to use its power over the investee to affect its returns.

The acquisition method of accounting is used to account for business combinations by the Group (refer to note 19).

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Foreign currency translation

Group companies

The results and financial position of foreign operations (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- ▶ assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- ▶ non-monetary assets at the date of acquisition are translated at the historical rate and are not subsequently revalued;
- ▶ income and expenses for each statement of profit or loss and statement of comprehensive income are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- ▶ all resulting exchange differences are recognised in other comprehensive income and accumulated in a separate reserve within equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies at year-end exchange rates, are generally recognised in profit or loss. They are deferred in equity if they relate to qualifying cash flow hedges and qualifying net investment hedges or are attributable to part of the net investment in a foreign operation.

Foreign currency translation continued

Transactions and balances continued

Foreign exchange gains and losses that relate to borrowings are presented in the statement of profit or loss, within finance costs. All other foreign exchange gains and losses are presented in the statement of profit or loss on a net basis within administrative expenses.

Use of estimates and judgements

The Directors are required to make judgements, estimates and assumptions about the carrying amount of assets and liabilities that are not readily apparent from other sources. These estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical accounting judgements

The following are the critical judgements that the Directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements:

- ▶ capitalisation of internal installation costs:
 - ▶ a significant level of in-house installation of customers' meter assets is carried out by the Group, certain costs of which are capitalised (£39.7m in 2019) and depreciated as part of property, plant and equipment depreciation. Judgement is required by management to ascertain the appropriate categories and proportion of overheads and other expenses that are directly attributable to installation of meter assets. Typically, capitalised costs will include staff costs, and a systematic allocation of any production overheads, deemed to be directly attributable to the process of installing a meter owned by the Group. Other general and administrative overheads, such as sales, marketing and training costs, are expensed directly to profit and loss; and
- ▶ presentation of losses on disposal of certain meter assets as exceptional items:
 - ▶ as a result of the inherent volatility associated with the smart meter rollout, and removal of traditional meter assets as part of this, management has taken the decision to show losses arising on disposal of these meters, being the net book value less the associated termination income received representing proceeds on disposal, as exceptional administrative expenses. By disclosing these amounts separately, the traditional meter asset portfolio can be better tracked to assist the users of the financial statements. A loss on disposal of traditional meter assets has been recognised as an exceptional cost in the year ended 31 December 2019. The change in accounting policy to reduce the residual value of the traditional meter asset portfolio to £nil (see note 10 for further details) was designed to reflect the consumption of economic benefit from installed assets, being the income earned from the provision of the meter. On disposal, the receipt of termination income, recognised as a component of the net gain or loss on the disposal of these meter assets, will vary depending on the energy supplier and is therefore not within our control. As the receipt of proceeds from disposal is inherently volatile, a loss on disposal can still arise in certain circumstances; and
 - ▶ technical communication issues for some first-generation smart meter assets (SMETS1 meters) on supplier churn have continued through 2019, with the enrolment and adoption process into the DCC delayed into 2020. As a result, the Group has continued to see a very small proportion of SMETS1 meters removed from the wall. As these removals are attributable to the temporary industry transition period, management has taken the judgement to recognise losses arising on the disposal of these meters as exceptional.

Key sources of estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that may have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

- ▶ recoverability of carrying value of meter assets portfolio:
 - ▶ as the smart meter rollout progresses, our portfolio of traditional meter assets is diminishing. It is therefore crucial that the recoverability of the carrying value of our meter assets, recognised in property, plant and equipment, be assessed. The two main drivers for assessing this recoverability are:
 - 1) the timing of the removals of these meters given this decision lies with the end consumer and removals are largely undertaken by third parties. We thus have little control over the timing and quantity of these removals; and
 - 2) the estimated future cash flows from termination income, which are derived using historical data and analysis around the risk of churn between contracted and non-contracted customers. This assessment includes consideration of the extent to which termination income and future rental income are received as traditional meters continue to be removed from the wall.

In 2019, this assessment has identified that the carrying value of the traditional meter assets portfolio is recoverable and, therefore, no impairment charge has been recognised. The carrying value of the traditional meter assets portfolio at 1 January 2019 included an impairment charge of £5.6m, which was recognised in 2018 as an exceptional cost of sales in line with our accounting policy (refer to details in note 10).

Revenue recognition

Refer to details in note 2.

Exceptional items and separately disclosed items

The Group presents as exceptional items on the face of the consolidated statement of comprehensive income those items of income and expense which, because of the material nature or expected infrequency of the events giving rise to them, merit separate presentation to allow shareholders to understand better the elements of financial performance in that year, so as to facilitate comparison with prior periods and to assess better trends in financial performance.

Termination fee income is reported as part of "Other operating income" on the consolidated statement of comprehensive income given the materiality and nature. Any termination fee income arising on the loss of meter assets is reported within administrative expenses as a component of net gain or loss on disposal. Termination fee income does not arise from the principal activities of the Group. Any such gain or loss on disposal relating to traditional meter assets and SMETS1 meter assets is disclosed as an exceptional item.

Financial assets

The Group's financial assets include cash and cash equivalents and trade and other receivables. Investments consist of an immaterial debt investment held at amortised cost.

Classification

The Group classifies its financial assets in the following measurement categories:

- ▶ those to be measured subsequently at fair value, either through other comprehensive income (FVOCI) or through profit or loss (FVPL); and
- ▶ those to be measured at amortised cost.

The classification depends on the Group's business model for managing the financial assets and the contractual terms of the cash flows.

For investments in equity instruments that are not held for trading, this will depend on whether the Group has made an irrevocable election at the time of initial recognition to account for the equity investment at FVOCI. The Group reclassifies debt investments when and only when its business model for managing those assets changes.

Recognition and derecognition

Financial assets are initially recognised on trade date. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership.

Measurement

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at FVPL, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost. They are generally due for settlement within 30 days and are therefore all classified as current. Due to their short-term nature, carrying value is considered to approximate fair value.

Cash and cash equivalents

Refer to accounting policy.

Impairment

The Group assesses, on a forward-looking basis, the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables and accrued income, which include contract assets and billed and unbilled receivables arising from contracts with customers, the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

Trade receivables and accrued income are written off, and derecognised, where there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the customer ceasing trading and entering administration with no expected recovery from the Supplier of Last Resort process, or a failure by the customer to make contractual payments for a period of greater than or equal to 365 days past due. Indicators are assessed on an individual customer basis. Impairment losses, including the loss allowance, on trade receivables and contract assets are presented within administrative expenses. Impairment losses on accrued termination income are presented within other operating income. Subsequent recoveries of amounts previously written off are credited against the same line item.

Further information about the impairment of trade receivables and accrued income, and the Group's exposure to credit risks, can be found in note 18.

Financial liabilities

The Group's financial liabilities include trade and other payables, bank loans and overdrafts.

Classification

Financial liabilities are classified as financial liabilities at fair value through profit or loss or loans and borrowings, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

Recognition

All financial liabilities are recognised initially at fair value and, in the case of bank loans, net of directly attributable transaction costs.

Measurement

Trade and other payables and bank overdrafts

Trade and other payables, and overdrafts, are subsequently measured at amortised cost using the effective interest rate method. Trade and other payables are presented as current liabilities unless payment is not due within twelve months after the reporting period. Due to their short-term nature, carrying value is considered to approximate fair value.

Bank loans

Bank loans are subsequently measured at amortised cost. Interest expense on bank loans is recognised in the consolidated income statement using the effective interest rate method.

Transaction costs on revolving credit facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all the facility will be drawn down. In this case, the fee is deferred within other assets until the drawdown occurs. Upon drawdown of the first loan, these costs are reclassified from other assets to bank loans and subsequently amortised over the term of the facility.

Borrowings are removed from the balance sheet when the obligation specified in the contract is discharged or cancelled or has expired. The difference between the carrying amount of a financial liability that has been extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred, or liabilities assumed, is recognised in profit or loss as other income or finance costs.

If a facility is modified, then it is assessed whether the modification is significant enough to constitute an extinguishment either qualitatively or quantitatively, where the change in present value of cash flows, including any transaction costs paid, exceeds 10%. If a modification is considered an extinguishment of the initial loan, the new modified loan is recorded at fair value and a gain/loss recognised immediately in the consolidated income statement for the difference between the carrying amount of the old loan and the new loan. Where a modification is not significant enough to be an extinguishment, the cash flows under the modified loan are rediscounted at the original effective interest rate and an immediate gain or loss is recognised accordingly in the consolidated income statement on the date of modification.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Offsetting of financial instruments

Financial assets and financial liabilities are offset, and the net amount reported in the consolidated statement of financial position, if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

Research and development

Expenditure on pure and applied research activities is recognised in the consolidated statement of comprehensive income as an expense as incurred.

Expenditure on product and system development activities is capitalised if the product or process is technically and commercially feasible and the Group intends and has the technical ability and sufficient resources to complete development; if future economic benefits are probable; and if the Group can measure reliably the expenditure attributable to the intangible asset during its development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads.

Capitalised development expenditure is stated at cost less accumulated amortisation and accumulated impairment losses.

Amortisation is calculated when the asset is available for use, so as to write off its cost, less its estimated residual value, over the useful economic life of that asset as follows:

- ▶ Development of ADM™ units 10% on cost straight line
- ▶ Development of internally generated information technology systems (IT development) 20% on cost straight line

Capitalised development expenditure on ADM™ units is disclosed within property, plant and equipment as part of meter assets and amortised over the same useful economic life as that applied to the tangible ADM™ unit.

Capitalised IT development expenditure is disclosed within intangible assets as part of IT development and software.

Development and software were previously disclosed separately but have been combined into a single asset class for the year ended 31 December 2019 as all costs capitalised within these categories relate to information technology and, with effect from 1 January 2019, are amortised over the same useful economic life of five years.

Intangible assets

Intangible assets acquired separately from third parties consist of software costs, including licence fees. These are recognised as assets, measured at cost and classified as part of IT development and software.

Internally generated intangible assets relate to IT development and are recognised as part of IT development and software. Refer to further details in the research and development accounting policy above.

Intangible assets acquired as part of a business combination are recognised outside goodwill if the asset is separable or arises from contractual or other legal rights. They are recognised at their fair value at the date of acquisition and are subsequently amortised on a straight line based on the timing of projected cash flows of the contracts over their estimated useful lives.

Following initial recognition, intangible assets are measured at cost at the date of acquisition less any amortisation and any impairment losses. Amortisation costs are included within the administrative expenses disclosed in the consolidated statement of comprehensive income.

Intangible assets are amortised over their useful lives as follows:

- ▶ IT development and software 20% on cost straight line
- ▶ Intangibles recognised upon acquisition:
 - ▶ Customer contracts 10% on cost straight line
 - ▶ Trademarks 33% on cost straight line

Useful lives are examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

Goodwill

Goodwill represents the excess of the consideration transferred over the fair value of the identifiable assets and liabilities of the acquiree at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is not amortised but is tested annually for impairment and is carried at cost less accumulated impairment losses. See note 12 for detailed assumptions and methodology. Impairment losses are not subsequently reversed.

Goodwill is allocated to cash-generating units (CGUs) for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The units or groups of units are identified at the lowest level at which goodwill is monitored for internal management purposes, being the operating segments.

Contingent consideration is recorded initially at fair value and classified as equity or a financial liability. Contingent consideration classified as equity is not remeasured, but contingent consideration classified as a financial liability is subsequently remeasured at fair value through profit or loss.

Adjustments to provisional fair values of identifiable assets and liabilities (and to estimates of contingent consideration) arising from additional information, obtained within the measurement period (no more than one year from the acquisition date), about facts and circumstances existing at the acquisition date are adjusted against goodwill. Other adjustments to provisional fair values or changes in contingent consideration are recognised through profit or loss.

Impairment

At each reporting date, the Group reviews the carrying amounts of its property, plant and equipment and intangibles, including goodwill, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have been adjusted.

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or CGU) in prior years. A reversal of an impairment loss is recognised as income immediately.

Detailed assumptions used in the annual impairment test for goodwill, with regard to discount, growth and inflation rates, are set out in note 12 to the accounts. Detailed assumptions used in the impairment test for meter assets, namely traditional meter assets, are set out in note 10.

Property, plant and equipment

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing part of the property, plant and equipment. When significant parts of property, plant and equipment are required to be replaced in intervals, the Group recognises such parts as individual assets with specific useful lives and depreciation, respectively. Pursuant to the acquisition of the meter installation businesses on 18 March 2016 certain internal costs to the Group are also capitalised where they are demonstrated as being directly attributable to bringing the meter assets into their usable condition.

All other repair and maintenance costs are recognised in the consolidated statement of comprehensive income as incurred.

For each asset depreciation is calculated using the straight line method to allocate its cost, net of its residual value if applicable, over its estimated useful life as follows:

- | | |
|------------------------------------|---|
| ▶ Freehold property | 2% |
| ▶ Short leasehold property | Shorter of the lease term or 15% and 20% |
| ▶ Meter assets | Smart and I&C 5% |
| | ADM™ units 10% |
| | Traditional to 31 December 2022 |
| ▶ Plant and machinery | 33% on cost |
| ▶ Fixtures, fittings and equipment | 20% and 33% on cost |
| ▶ Motor vehicles | 25% on cost |
| ▶ Right-of-use assets | Shorter of the asset's useful life and the lease term |

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of comprehensive income when the asset is derecognised. The asset's residual values, useful lives and methods of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

Property, plant and equipment is initially recorded at cost.

The following changes in estimates with regard to property, plant and equipment were made with effect from 1 January 2019:

- ▶ Subsequent to the impairment review carried out at 31 December 2018, the estimate of residual value on the domestic traditional meter asset portfolio has been reduced to 0% to reflect management's updated forecasts and assumptions regarding the recoverability of value on these assets. As a result, the income statement has been charged with an additional c.£7.3m, recognised within depreciation in cost of sales.

The following changes in estimates with regard to property, plant and equipment were made with effect from 1 January 2018:

- ▶ A review concluded that there should be a change to the I&C electric estimate of useful life from 15 years to 20 years on the basis that these meters are no longer subject to a certification period and fall under the same considerations as smart meters. The impact on the financial statements for the year to 31 December 2018 was a decrease to the depreciation charge in the consolidated income statement and statement of comprehensive income of £266,000.
- ▶ The I&C gas portfolio saw the estimate of residual value reduce to 0% to reflect revised customer terms in new customer contracts. As a result, the income statement for the year to 31 December 2018 was charged with an additional £340,000 recognised within depreciation in cost of sales.
- ▶ With respect to the domestic traditional meter asset portfolio, the useful life of all opening assets was extended to 5 years to reflect the fact that the expected end date for the domestic smart meter rollout is likely to be at the end of 2022. It is accepted that the rate of meter exchange to smart meters will vary year by year as the rollout proceeds but there is currently no reliable basis on which to predict the annual profile. Accordingly, a straight line approach to depreciation of these assets continues to be adopted. The impact on the financial statements for the year to 31 December 2018 was a decrease to the depreciation charge in the consolidated income statement and statement of comprehensive income of £2.9m.

See note 29 for further details on the recognition and measurement of right-of-use assets under IFRS 16.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and purchases of meter assets at cost. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Cash and cash equivalents

Cash and cash equivalents in the consolidated statement of financial position comprises cash at bank and in hand and short-term deposits with an original maturity of three months or less. For the purpose of the consolidated statement of cash flows, cash and cash equivalents consists of cash and short-term deposits as defined above, net of outstanding bank overdrafts.

Leased assets and obligations as lessee

With effect from 1 January 2019

As of 1 January 2019, SMS adopted IFRS 16 Leases. Refer to details in note 29.

Up to 31 December 2018

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. Assets acquired under finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is recorded in the balance sheet as a finance lease obligation. The lease payments are apportioned between finance charges to the income statement and a reduction of the lease obligations.

Rental payments under operating leases are charged to the income statement on a straight line basis over the applicable lease periods.

Group as lessor

With effect from 1 January 2019

As of 1 January 2019, SMS adopted IFRS 16 Leases. Refer to details in note 29.

Up to 31 December 2018

Leases in which the Group does not transfer substantially all the risks and rewards of ownership of assets are classified as operating leases with meter income recognised in line with the meter rental income policy.

Pension costs

The Group operates a defined contribution pension scheme for employees. The assets of the scheme are held separately from those of the Group. The annual contributions payable are charged to the consolidated statement of comprehensive income.

Share-based payments

IFRS 2 Share-based Payment has been applied to all grants of equity instruments. The Group issues equity-settled share-based payments to certain employees under the terms of the Group's various employee share and option schemes. Equity-settled share-based payments are measured at fair value at the date of the grant. The fair value determined at the grant date of equity-settled share-based payments is expensed on a straight line basis over the vesting period, based on an estimate of the shares that will ultimately vest.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction from the proceeds.

Own share reserve

The Group offers a Share Incentive Plan for all employees and has established a trust to facilitate the delivery of SMS shares under this plan. The holdings of this trust include shares that have not vested unconditionally to employees of the Group. These shares are recorded at cost and are classified as own shares. The cost to the Company of acquiring these own shares held in trust is shown as a deduction from shareholders' equity.

Dividends

Dividend distributions to the Company's shareholders are recognised in the accounting period in which the dividends are paid.

Taxation

Tax currently payable is based on the taxable profit for the year and any adjustment to tax payable in respect of prior years. Taxable profit differs from accounting profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is measured using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax is the tax expected to be payable or recoverable on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax is recognised in respect of all temporary differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date.

Deferred tax is measured at the tax rates that are expected to apply in the periods in which the asset or liability is settled based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. It is recognised in the income statement except when it relates to items recognised in other comprehensive income or directly in equity, such as share-based payments. In this case, the deferred tax is also recognised in other comprehensive income or directly in equity, respectively.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary difference can be utilised. Their carrying amount is reviewed at each balance sheet date on the same basis.

Deferred tax liabilities are recognised for all temporary differences, except in respect of:

- ▶ temporary differences arising from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss; and
- ▶ temporary differences associated with investments in subsidiaries where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Standards and interpretations

New and amended standards adopted by the Group

The Group has applied the following standards and amendments for the first time for their annual reporting period commencing 1 January 2019:

Standard or interpretation		Effective date
IFRS 16	Leases	1 January 2019
Various	Annual Improvements to IFRSs – 2015–2017 Cycle	1 January 2019
IFRIC 23	Uncertainty over Income Tax Treatments	1 January 2019

The Group had to change its accounting policies as a result of adopting IFRS 16. See further details in note 29. The other amendments listed above did not have any impact on the amounts recognised in prior periods and the current period and are not expected to significantly affect future periods. The Group does not currently have any material uncertain tax positions.

The following new accounting standards and interpretations have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Group. These standards are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions:

Standard or interpretation		Effective date
IFRS 3 (amendment)	Definition of a Business	1 January 2020
IAS 1 and IAS 8 (amendment)	Definition of Material	1 January 2020
CF	Conceptual Framework for Financial Reporting	1 January 2020

For the year ended 31 December 2019

1 Segmental reporting

For management purposes, the Group is organised into three core divisions, as follows:

- ▶ asset management, which comprises regulated management of gas meters, electric meters and ADM™ units within the UK;
- ▶ asset installation, which comprises installation of domestic and I&C gas meters and electricity meters throughout the UK; and
- ▶ energy management, which comprises the provision of energy consultancy services and, following the acquisition of Solo Energy Limited, the management of Distributed Energy Resources (DER) assets.

The Group's chief operating decision maker (CODM), being the SMS plc Board, receives certain management information at a granular "utility" level. Asset management includes reporting on gas meter rental, electricity meter rental, gas data and electricity data. Asset installation includes reporting on gas transactional work and electricity transactional work. However, whilst the Group has the ability to analyse its underlying information in this way, this information is only used to assess performance for the Group as a whole. These utility levels are thus combined within asset management and asset installation, respectively, on the basis that they have similar long-term economic characteristics – they derive from the same asset, use similar delivery processes, have consistent customers and have similar long-term gross margins.

For the purpose of making decisions about resource allocation and performance assessment, it is the operating results of the three core divisions listed above that are monitored by management and the CODM. It is these divisions, therefore, that are defined as the Group's reportable operating segments.

Segment performance is evaluated based on gross profit.

The following segment information is presented in respect of the Group's reportable segments together with additional balance sheet information:

	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
31 December 2019					
Segment revenue	82,907	59,968	9,024	—	151,899
Inter-segment revenue	—	(37,618)	—	—	(37,618)
Revenue from external customers	82,907	22,350	9,024	—	114,281
Cost of sales	(37,389)	(27,981)	(6,847)	—	(72,217)
Segment gross profit	45,518	(5,631)	2,177	—	42,064
Other operating costs/income	—	—	—	(14,659)	(14,659)
Depreciation	(1,347)	—	—	(2,299)	(3,646)
Amortisation of intangibles	(1,473)	—	(10)	—	(1,483)
Exceptional items	(8,085)	(51)	—	(391)	(8,527)
Profit from operations	34,613	(5,682)	2,167	(17,349)	13,749
Net finance costs: exceptional	(104)	—	—	—	(104)
Net finance costs: other	(8,065)	—	—	(118)	(8,183)
Profit before tax	26,444	(5,682)	2,167	(17,467)	5,462
Tax expense	—	—	—	—	(1,465)
Profit for year					3,997
31 December 2018					
Segment revenue	65,468	52,153	6,469	—	124,090
Inter-segment revenue	—	(25,598)	—	—	(25,598)
Revenue from external customers	65,468	26,555	6,469	—	98,492
Cost of sales	(25,746)	(20,500)	(5,087)	—	(51,333)
Segment gross profit	39,722	6,055	1,382	—	47,159
Other operating costs/income	—	—	—	(15,930)	(15,930)
Depreciation	—	(280)	—	(1,126)	(1,406)
Amortisation of intangibles	(2,597)	—	—	—	(2,597)
Exceptional items	(12,652)	(1,653)	—	(1,836)	(16,141)
Profit from operations	24,473	4,122	1,382	(18,892)	11,085
Net finance costs: exceptional	(996)	—	—	—	(996)
Net finance costs: other	(4,738)	—	—	—	(4,738)
Profit before tax	18,739	4,122	1,382	(18,892)	5,351
Tax expense	—	—	—	—	(887)
Profit for year					4,464

1 Segmental reporting continued

Inter-segment revenue relates to installation services provided by the asset installation segment to the asset management segment.

Depreciation of £31.5m (2018: £20.4m) associated with meter assets has been reported within cost of sales, in the asset management segment, as the meter assets directly drive revenue.

All revenues and operations are based and generated in the UK.

The Group has one major customer that generated turnover within each segment as listed below:

	2019 £'000	2018 £'000
Customer 1 – asset management	14,030	6,024
Customer 1 – asset installation	796	1,753
	14,826	7,777

Segment assets and liabilities

	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
31 December 2019					
Assets reported by segment					
Intangible assets	18,417	3,493	1,833	—	23,743
Property, plant and equipment	403,948	518	—	8,192	412,658
Inventories	21,734	327	—	—	22,061
Contract assets	—	11	—	—	11
	444,099	4,349	1,833	8,192	458,473
Assets not by segment					98,902
Total assets					557,375
Liabilities by segment					
Contract liabilities	1,360	2,010	124	—	3,494
Lease liabilities	893	—	—	3,072	3,965
Bank loans	269,260	—	—	—	269,260
	271,513	2,010	124	3,072	276,719
Liabilities not by segment					57,079
Total liabilities					333,798
31 December 2018					
Assets reported by segment					
Intangible assets	13,643	3,495	—	—	17,138
Property, plant and equipment	350,360	2,463	—	3,909	356,732
Inventories	10,762	499	—	—	11,261
Contract assets	2	20	—	—	22
	374,767	6,477	—	3,909	385,153
Assets not by segment					64,519
Total assets					449,672
Liabilities by segment					
Contract liabilities	1,010	1,801	418	—	3,229
Bank loans	172,016	—	—	—	172,016
	173,026	1,801	418	—	175,245
Liabilities not by segment					48,294
Total liabilities					223,539

For the year ended 31 December 2019

1 Segmental reporting continued**Segment assets and liabilities** continued

Assets not by segment include cash and cash equivalents, trade and other receivables and investments. In 2018, assets not by segment included cash and cash equivalents, trade and other receivables, other assets and investments.

Liabilities not by segment include trade and other payables and deferred tax liabilities. In 2018, liabilities not by segment included trade and other payables, other liabilities and deferred tax liabilities.

Additions to non-current assets within each segment are listed below:

	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
Additions to non-current assets					
2019	106,452	509	67	6,495	113,523
2018	134,882	2,685	—	963	138,530

2 Revenue from contracts with customers**2 (a) Disaggregation of revenue from contracts with customers**

The Group reports the following segments: asset management, asset installation and energy management, in accordance with IFRS 8 Operating Segments. We have determined that, to meet the objective of the disaggregation disclosure requirement in paragraph 114 of IFRS 15, which is to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors, further disaggregation is required into the major types of services offered. The following table thus discloses segmental revenue by type of service delivered and timing of revenue recognition, including a reconciliation of how this disaggregated revenue ties in with the asset management, asset installation and energy management segments, in accordance with paragraph 115 of IFRS 15.

Year ended 31 December 2019	Asset management £'000	Asset installation £'000	Energy management £'000	Total operations £'000
Major service lines				
Metering	75,472	—	—	75,472
Data management	7,435	—	—	7,435
Utility connections	—	8,406	—	8,406
Transactional meter works	—	13,295	—	13,295
Energy management	—	649	9,024	9,673
	82,907	22,350	9,024	114,281
Timing of revenue recognition				
Services transferred at a point in time	—	13,172	—	13,172
Services transferred over time	82,907	9,178	9,024	101,109
	82,907	22,350	9,024	114,281
Year ended 31 December 2018	Asset management £'000	Asset installation £'000	Energy management £'000	Total operations £'000
Major service lines				
Metering ¹	58,507	—	—	58,507
Data management	6,961	—	—	6,961
Utility connections	—	9,687	—	9,687
Transactional meter works	—	16,290	—	16,290
Energy management	—	578	6,469	7,047
	65,468	26,555	6,469	98,492
Timing of revenue recognition				
Services transferred at a point in time	—	14,677	—	14,677
Services transferred over time	65,468	11,878	6,469	83,815
	65,468	26,555	6,469	98,492

¹ The "Metering" service line within asset management includes operating lease rental income recognised under IAS 17. Approximately 86% of the revenue recognised of £58,507,000 in 2018 relates to operating lease income. See note 29 for further details on the Group's lessor accounting under IFRS 16, effective 1 January 2019.

2 Revenue from contracts with customers continued

2 (b) Assets and liabilities related to contracts with customers

The Group has recognised the following assets and liabilities related to contracts with customers:

	2019 £'000	2018 £'000
Current contract assets	11	22
Total contract assets	11	22
Current contract liabilities	3,494	3,229
Total contract liabilities	3,494	3,229

Trade receivables and unbilled receivables are disclosed in note 14.

(i) Significant changes in contract assets and liabilities

Contract assets and contract liabilities have not changed significantly and movements reflect the general timing of revenue recognition and status of services in progress at the end of the year.

(ii) Revenue recognised in relation to contract liabilities

The following table shows how much of the revenue recognised in the current period relates to carried-forward contract liabilities:

	2019 £'000	2018 £'000
Revenue recognised that was included in the contract liability balance at the beginning of the period	3,057	3,139

No revenue was recognised in 2019 in relation to performance obligations satisfied in previous periods.

(iii) Transaction price for which performance obligations not satisfied

All our utilities connections and energy management contracts are either for periods of one year or less or are billed periodically based on time and resources incurred, or other unit measures. As permitted under IFRS 15, the transaction price allocated to these performance obligations unsatisfied at the end of the reporting period is not disclosed.

2 (c) Accounting policies and significant judgements

(i) Metering

Meter rental

The Group acts as a gas and electricity meter asset provider, providing and installing meters to energy suppliers on behalf of the end consumer.

With effect from 1 January 2019

As a result of the Group's assessment of contracts on implementation of IFRS 16, and any potential interaction with IFRS 15, the arrangements the Group has in place to act as meter asset provider were reconsidered and it was determined that the contract does not constitute a lease of the meter asset to the energy supplier. See note 29 for further details. With effect from 1 January 2019, therefore, the related income for the service of providing a fitted meter is recognised in accordance with IFRS 15.

The provision of meter assets to energy suppliers (MAP services), together with the initial installation, is considered a distinct and single performance obligation on the basis that, as Meter Asset Provider (MAP), the Group has an obligation to its customers to provide a fitted meter. This is a separately identifiable service to which a stand-alone selling price is typically allocated. Over the course of the contract term, which runs into perpetuity, the Group delivers a series of monthly services for which benefits are simultaneously received and consumed by the customer.

MAP charges are calculated daily based on the number of installed meters and invoiced to customers monthly once validation checks have been completed. As revenue from MAP charges is attributed to services provided daily, revenue is always based on the actual level of service provided and, therefore, any uncertainty at the end of each reporting period is limited to the extent that validation checks are still being completed. Revenue is thus recognised over time based on our right to invoice and includes contract RPI uplifts.

As a result of industry regulations, and subject to specific contract terms with a customer, the Group may be required to make payments to customers for shortfalls in the level of service provided. These charges are directly related to the service being provided to the customer and thus recognised as a reduction to revenue in the month in which the service failure occurred. Where service levels are set based on annual targets, charges are estimated monthly and subsequently finalised at the end of the year. Uncertainty, as it pertains to these payments to customers, is thus typically resolved by the end of the reporting period.

If a MAP contract is cancelled, termination fees may be levied on the energy supplier. There has been no change in the accounting of these termination fees and they continue to be classified within other operating income unless they have arisen on the loss of the meter assets, in which case they are reported within administrative expenses as a component of net gain or loss on disposal.

For the year ended 31 December 2019

2 Revenue from contracts with customers continued

2 (c) Accounting policies and significant judgements continued

(i) Metering continued

Meter rental continued

With effect from 1 January 2019 continued

If the services rendered by the Group exceed the payment received, then accrued income is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

Up to 31 December 2018

The provision of the meter asset is accounted for as an operating lease under IAS 17 on the basis that the energy suppliers have control of the data being collected from the meter over the duration of the contract. Meter rentals receivable from energy suppliers are accounted for as operating lease payments and recognised as rental income under IAS 17. This income is calculated daily, based on the number of meter assets, and invoiced to customers monthly. Rental contracts do not operate on a fixed-term basis and are cancellable at any time by the lessee.

The installation of the meter is considered integral to the use of the underlying asset and therefore is accounted for as part of the lease of the meter. Consideration for installation is recognised as part of the total consideration earned from meter rentals.

If a rental contract is cancelled termination payments may be levied on the energy supplier. In line with the underlying contractual terms, termination fees due are recognised at fair value upon notification of de-appointment and are classified as other operating income unless the fees have arisen on the loss of meter assets, in which case they are reported within administrative expenses as a component of net gain or loss on disposal.

If the services rendered by the Group exceed the payment received, then accrued income is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

Asset management services

The Group provides meter asset management and operations services to energy suppliers. These services are considered a distinct performance obligation from the meter rental on the basis that these are separately identifiable services to which a stand-alone selling price is allocated, and they are not necessary to bring the meter asset into use.

Over the course of the contract term, which can either be fixed or into perpetuity, the Group delivers a series of monthly services for which the benefits are simultaneously received and consumed by a customer. Therefore, these are accounted for as a single performance obligation.

Service charges are calculated daily based on the number of meters appointed and invoiced to customers monthly. As revenue from service charges is attributed to services provided daily, revenue is always based on the actual level of service provided and, therefore, there is no uncertainty at the end of each reporting period. Revenue is thus recognised over time based on our right to invoice and includes contract RPI uplifts.

The Group's meter asset management contracts also include the provision of transactional meter works. These are considered further in accounting policy (iv) below.

If the services rendered by the Group exceed the payment received, then a contract asset is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

(ii) Data services

The Group provides data collection and aggregation services to I&C electricity customers and, through use of the ADM™ unit, to I&C gas customers. Over the course of the contract term, which can either be fixed or into perpetuity, the Group delivers a series of monthly services for which the benefits are simultaneously received and consumed by a customer. Therefore, these are accounted for as a single performance obligation.

Service charges are calculated based on the number of meters/ADM™ units appointed and invoiced to customers monthly. As revenue from service charges is attributed to services provided periodically, revenue is always based on the actual level of service provided and, therefore, there is no uncertainty at the end of each reporting period. Service charges, including contract RPI uplifts, are billed to clients annually in advance and therefore a contract liability is recognised and subsequently released to the income statement over the year on a straight line basis. The Group uses the practical expedient under IFRS 15 from adjusting revenue for any significant financial components of one year or less.

The ADM™ device is a proprietary product for the Group and there are no other market providers of this device. A customer cannot therefore benefit from the data services without installation, and the installation is not separately identifiable as it is integral to the subsequent data services. This is therefore accounted for along with the data services as a single performance obligation and any corresponding charges are recognised over the term of the contract.

(iii) Utility connections services (gas and electricity)

Gas and electricity connections services are provided under fixed-price contracts with I&C customers and can be delivered to a single site or multiple sites. Whilst each service consists of multiple activities, the Group's promise in the contract is to deliver an integrated end-to-end service to which the underlying activities are inputs. Where services are delivered to multiple sites, and these are substantially the same, a series of services is being provided. In all cases, therefore, these contracts give rise to a single performance obligation to which the fixed price is allocated. Subsequent variations to this price, due to changes in the inputs required, are accounted for as contract modifications and recognised on a cumulative catch-up basis.

2 Revenue from contracts with customers continued

2 (c) Accounting policies and significant judgements continued

(iii) Utility connections services (gas and electricity) continued

Services are transferred over time on the basis that these are customised services with no alternative use and the Group has an enforceable right to payment for work completed to date.

Revenue is recognised on the stage of completion with reference to the actual services provided as a proportion of the total service expected to be provided under the contract as the services can enhance a work in progress asset for the customer and have no alternative use. This is determined on a contract by contract basis using a milestone approach with reference to the milestones set out in the contract or otherwise agreed. Where relevant, consideration is also given to material services provided between milestones. Estimates of revenues, costs or extent of progress towards completion are revised if circumstances change and any resulting increases or decreases in estimated revenues or costs are reflected in profit or loss in the period in which the circumstances that give rise to the revision become known by management.

The customer pays the fixed amount based on a payment schedule. In certain circumstances the customer pays in advance and therefore a contract liability is recognised and subsequently released to the income statement based on the measure of progress detailed above. As the contract is cancellable at the customer's discretion, subject to settlement for services provided to the date of cancellation, a contract liability is not recognised until the cash has been received.

If the services rendered by the Group exceed the payment received, then a contract asset is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

The Group utilises the practical expedient available under IFRS 15 for costs to obtain a contract. Commissions paid as part of obtaining a contract are expensed as incurred on the basis that the contract term is typically less than twelve months.

(iv) Transactional meter works

Transactional works, which include emergency, adversarial and other maintenance services, and are typically short term in nature, are accounted for as a separate performance obligation to asset management services (see section (i) above) on the basis that these are separately identifiable and can be performed by another party. A customer, being the energy supplier, is legally obligated to appoint a meter asset manager and can therefore benefit from this service in isolation, without the subsequent transactional works which are initiated on an ad-hoc basis upon demand by the customer.

Transactional meter works also include contracts with customers for installation-only services.

The transaction price allocated to transactional works is based on stand-alone selling prices (per unit, where relevant) and revenue is recognised at a point in time when the transaction has been completed and accepted by the customer. This is the point at which the customer is charged for the service and a receivable is recognised by the Group as we have an unconditional right to payment. The customer will settle the transaction price for these services as part of the regular monthly billing cycle for metering services.

The customer pays the fixed amount based on the transactional services provided and this is charged once the service has been completed and accepted by the customer.

For segmental purposes, this transactional, non-recurring revenue is recognised within asset installation.

(v) Energy management services

Energy management services provided mainly to I&C customers include utility bureau and bill validation services, risk management and procurement services and energy reduction and environmental management services.

Certain services, such as utility bureau and bill validation, are delivered through a series of monthly services over the course of the contract term, for which the benefits are simultaneously received and consumed by a customer. These are accounted for as a single performance obligation. The transaction price allocated includes a fixed monthly service charge together with a variable component for specific activities that may not be carried out every month. As revenue from charges is attributed to services provided monthly, revenue is always based on the actual level of service provided and, therefore, there is no uncertainty at the end of each reporting period. Revenue is thus recognised over time based on our right to invoice.

Contracts for specialist consultancy services may include multiple projects. Where these projects are separately identifiable within the contract and are not interrelated, they are accounted for as separate performance obligations. The transaction price is allocated based on the stand-alone charges for each project.

Other energy reduction and environmental management services are typically longer-term, multi-site contracts and, therefore, the revenue recognition is consistent with that detailed above for utility connections – see details in note 2 (c)(iii) above.

(vi) Assets and liabilities arising from contracts with customers

Costs to fulfil a contract

In certain circumstances, the Group may incur costs to fulfil its obligations under a contract once it is obtained, but before transferring goods or services to the customer. These costs are assessed on a contract by contract basis and, where they are considered to meet the definition of fulfilment costs under IFRS 15, they are recognised as an asset and amortised on a systematic basis consistent with the pattern of transfer of the services to which the asset relates.

For the year ended 31 December 2019

2 Revenue from contracts with customers continued**2 (c) Accounting policies and significant judgements** continued**(vi) Assets and liabilities arising from contracts with customers** continued**Contract assets and liabilities**

We receive payments from customers based on a billing schedule, as established in our contracts.

The timing of revenue recognition, billing and cash collections results in:

- ▶ billed and unbilled accounts receivable, which are recognised when our right to consideration becomes unconditional, and classified as trade receivables and accrued income respectively;
- ▶ unbilled amounts, where we have a conditional right to consideration based on future performance, recognised as contract assets. These amounts will be billed in accordance with the agreed upon contractual terms; and
- ▶ payments received in advance of performance under a contract, recognised as contract liabilities. Contract liabilities are recognised as revenue as (or when) we perform under a contract.

For project-based services, work in progress is billed in accordance with the agreed upon contractual terms with the customer. We typically receive interim payments as work progresses, which can give rise to a billed or unbilled accounts receivable, where our right to payment is unconditional, or a contract asset, where revenue has been recognised based on progress completed but our right to payment is still conditional on future performance. For some contracts, we may be entitled to receive advance payments. We recognise a contract liability for these advance payments in excess of revenue recognised.

Cancellation terms can vary but typically include provisions that allow the customer to terminate the contract at their discretion subject to a penalty or settlement of amounts for work completed prior to termination. Contracts allow both parties to cancel without penalty in the case of a material breach of contract.

3 Profit from operations

The Group has identified a number of items which are material due to the significance of their nature and/or amount. These are listed separately here to provide a better understanding of the financial performance of the Group.

	2019 £'000	2018 £'000
Profit from operations is stated after (charging)/crediting:		
Cost of sales:		
Direct subcontractor costs	(7,195)	(6,786)
Depreciation of meter assets	(31,491)	(20,390)
Direct staff and other costs	(31,212)	(22,335)
Inventory costs	(2,319)	(1,822)
Total cost of sales (before exceptional items)	(72,217)	(51,333)
Administrative expenses:		
Staff costs	(12,380)	(11,447)
Depreciation:		
– owned assets	(2,729)	(1,406)
– leased assets	(917)	–
Amortisation of intangibles	(1,483)	(2,597)
Auditor's remuneration (note 3a)	(300)	(191)
Loss on disposal	(2,701)	(1,659)
Operating lease rentals ¹	(1,032)	(2,041)
Research and development costs	–	(307)
Other operating charges	(3,972)	(1,615)
Total administrative expenses (before exceptional items)	(25,514)	(21,263)
Exceptional items (note 3b)	(8,527)	(16,141)
Other operating income (note 3c)	5,726	1,330
Total operating costs	(100,532)	(87,407)

1 2019 operating lease rentals include £1,010,000 on short-term leases and £22,000 on leases of low value assets.

3 Profit from operations continued

3 (a) Auditor's remuneration

Auditor's remuneration can be analysed as:

	2019 £'000	2018 £'000
Audit of the parent company and consolidated financial statements	95	55
Audit of the financial statements of the Company's subsidiaries	155	107
Other services – audit related assurance services	50	29
	300	191

3 (b) Exceptional items

There are total exceptional items on the consolidated income statement of £8,631,000.

Exceptional operating costs comprise £6,837,000 for losses on disposal of our meter portfolio (£11,819,000 net book value less £4,982,000 termination income), £1,999,000 of legal and professional fees incurred as part of the conditional sale of a minority of our assets, £751,000 SMETS1 meters stock write-back, £96,000 of redundancy costs relating to the reorganisation of subsidiaries, £92,000 of costs incurred in relation to the acquisition of Solo Energy Limited, £82,000 of costs that the Company has agreed to settle in relation to a former legacy Employee Benefit Trust, £68,000 of deferred remuneration arising on the acquisition of a subsidiary in 2016 settled in shares in April 2019 and £104,000 impairment charges.

Exceptional finance costs of £104,000 include £98,000 accelerated amortisation of loan arrangement fees in relation to the refinancing of the loan facility and £6,000 of bank break fees.

In 2018, there are total exceptional items on the consolidated income statement of £17,137,000. Exceptional operating costs comprise £12,652,000 for losses on our meter portfolio (including an impairment charge of £5,612,000), £1,653,000 traditional meters stock write down, £720,000 of deferred remuneration arising on the acquisition of a subsidiary in 2016 to be settled in shares, £810,000 of costs that the Company has agreed to settle in relation to a former legacy Employee Benefit Trust, £198,000 of redundancy costs relating to the reorganisation of subsidiaries and £108,000 impairment of subsidiary undertaking SMS Italia SRL, together with associated costs.

Exceptional finance costs of £996,000 include £358,000 accelerated amortisation of bank loan fees and £635,000 legal and professional fees incurred in conjunction with the refinancing of the loan facility and £3,000 of bank break fees.

The tax effect of exceptional items charged in 2019 is a credit of £1,119,000 (2018: £2,948,000).

3 (c) Other operating income

In 2019, other operating income represents termination fee income and non-recurring, contractual charges.

In 2018, other operating income represents termination fee income only.

4 Particulars of employees

The average number of staff employed by the Group during the financial year, including Executive Directors, by activity was:

	2019 Number	2018 Number
Administrative staff	487	263
Operational staff	669	602
Sales staff	4	3
IT staff	62	45
Directors (excluding 4 (2018: 3) Non-executive Directors)	3	2
	1,225	915

The aggregate payroll costs, including Executive Directors, of the employees were:

	2019 £'000	2018 £'000
Wages and salaries	39,817	29,993
Social security costs	4,400	3,047
Staff pension costs	1,115	638
Share-based payment (note 23)	671	1,208
Director pension costs	11	8
	46,014	34,894

For the year ended 31 December 2019

5 Finance costs and finance income

	2019 £'000	2018 £'000
Finance costs		
Bank loans and overdrafts	8,255	4,962
Lease liabilities	157	—
Foreign exchange loss on intragroup borrowings	49	—
Total pre-exceptional finance costs	8,461	4,962
Exceptional finance costs	104	996
Total finance costs	8,565	5,958
Finance income		
Bank interest receivable	278	224
Total finance income	278	224

6 Taxation

	2019 £'000	2018 £'000
Analysis of charge in the year		
Current tax:		
Current income tax expense	(81)	(127)
Adjustment to tax charge in respect of previous periods	2	(37)
Total current income tax	(79)	(164)
Deferred tax:		
Origination and reversal of temporary differences	1,405	1,056
Adjustment to tax charge in respect of prior periods	139	(5)
Tax on profit	1,465	887

The charge for the period can be reconciled to the profit per the consolidated statement of comprehensive income as follows:

Profit before tax	5,462	5,351
Tax at the UK corporation tax rate of 19.00% (2018: 19.00%)	1,038	1,017
Expenses not deductible for tax purposes	420	40
Deferred tax not recognised	—	—
Adjustments to tax charge in respect of previous periods	142	(43)
Change in tax rate	(135)	(127)
Tax expense in the income statement	1,465	887

Current tax credit through equity in the year was £Nil (2018: £85,000).

7 Earnings per share (EPS)

The calculation of EPS is based on the following data and number of shares:

	2019 £'000	2018 £'000
Profit for the year used for calculation of basic EPS	3,997	4,464
Number of shares	2019	2018
Weighted average number of ordinary shares for the purposes of basic EPS	112,446,154	112,408,338
Effect of potentially dilutive ordinary shares:		
– share options	823,258	1,056,897
Weighted average number of ordinary shares for the purposes of diluted EPS	113,269,412	113,465,235
EPS:		
– basic (pence)	3.56	3.97
– diluted (pence)	3.53	3.93

8 Dividends

	Year ended 31 December 2019 £'000	Year ended 31 December 2019 Per share (pence)	Year ended 31 December 2018 £'000	Year ended 31 December 2018 Per share (pence)
Paid final dividend	4,485	3.98	3,892	3.46
Paid interim dividend	2,594	2.30	2,251	2.00
Total dividends	7,079	6.28	6,143	5.46

A second interim dividend of 4.58p per share and no final dividend for 2019 (2018: no second interim dividend, final dividend of 3.98p) has been recommended by the Directors. The second interim dividend will be paid in June 2020, amounts to c.£5,162,000 and will be accounted for in 2020. Including the first interim dividend for 2019 of 2.30p per share (2018: 2.00p), this gives a full-year dividend for 2019 of 6.88p per share (2018: 5.98p).

Second interim and final paid dividends are paid out of profits recognised in the year prior to the year in which the dividends are declared and reported.

As at 31 December 2019, the distributable profits in the parent company were adequate to cover the proposed second interim of c.£5,162,000.

9 Intangible assets

	Goodwill £'000	Intangibles recognised upon acquisition £'000	IT development and software ¹ £'000	Total £'000
Cost				
As at 1 January 2018	7,609	2,166	11,813	21,588
Additions	—	—	5,887	5,887
Disposals	—	—	(22)	(22)
As at 31 December 2018	7,609	2,166	17,678	27,453
Additions	—	—	6,936	6,936
Acquisitions	995	96	697	1,788
Reclassifications ²	—	—	(205)	(205)
Disposals	—	—	(639)	(639)
Exchange adjustments	(57)	(5)	(22)	(84)
As at 31 December 2019	8,547	2,257	24,445	35,249
Amortisation				
As at 1 January 2018	—	1,601	6,117	7,718
Charge for year	—	433	2,164	2,597
As at 31 December 2018	—	2,034	8,281	10,315
Reclassifications ²	—	—	(74)	(74)
Disposals	—	—	(218)	(218)
Charge for year	—	137	1,346	1,483
As at 31 December 2019	—	2,171	9,335	11,506
Net book value				
As at 31 December 2019	8,547	86	15,110	23,743
As at 31 December 2018	7,609	132	9,397	17,138
As at 1 January 2018	7,609	565	5,696	13,870

1 In the 2018 financial statements development and software were disclosed separately. These have been combined into a single asset class, IT development and software, for the year ended 31 December 2019 as all costs capitalised within these categories relate to IT and, with effect from 1 January 2019, are amortised over the same useful economic life.

2 Capitalised development expenditure on ADM™ units has been reallocated from IT development and software in intangible assets to meter assets within property, plant and equipment, to align with the Group's accounting policy.

The acquisition of Solo Energy Limited in September 2019 resulted in the recognition of goodwill of £995,000, which has been assigned to the energy management operating segment. In addition, the trademarks of Solo Energy Limited and its FlexiGrid platform were valued at £96,000 and have been recognised as additions within the acquired intangibles asset class. See note 19 for further details on this business acquisition.

For the year ended 31 December 2019

10 Property, plant and equipment

	Freehold/ leasehold property £'000	Meter assets £'000	Plant and machinery £'000	Fixtures, fittings and equipment £'000	Motor vehicles £'000	Right-of-use assets £'000	Total £'000
Cost							
As at 1 January 2018	2,300	299,815	317	3,065	83	—	305,580
Additions	236	128,173	187	1,230	2,817	—	132,643
Disposals	—	(17,860)	—	(47)	(86)	—	(17,993)
As at 31 December 2018	2,536	410,128	504	4,248	2,814	—	420,230
Additions	215	95,186	520	2,498	3,279	4,889	106,587
Acquisitions	—	—	—	6	—	—	6
Reclassifications ¹	—	205	—	—	—	—	205
Impairment	—	—	—	—	—	(90)	(90)
Disposals	—	(21,991)	—	(894)	(65)	(54)	(23,004)
Exchange adjustments	—	—	—	—	—	—	—
As at 31 December 2019	2,751	483,528	1,024	5,858	6,028	4,745	503,934
Depreciation							
As at 1 January 2018	392	37,820	71	1,868	83	—	40,234
Charge for year	127	20,390	162	794	323	—	21,796
Impairment	—	5,612	—	—	—	—	5,612
Disposals	—	(4,056)	—	(44)	(44)	—	(4,144)
As at 31 December 2018	519	59,766	233	2,618	362	—	63,498
Charge for year	(14)	31,491	267	1,337	1,139	917	35,137
Reclassifications ¹	—	74	—	—	—	—	74
Impairment	—	—	—	—	—	(37)	(37)
Disposals	—	(6,520)	—	(841)	(35)	—	(7,396)
As at 31 December 2019	505	84,811	500	3,114	1,466	880	91,276
Net book value							
As at 31 December 2019	2,246	398,717	524	2,744	4,562	3,865	412,658
As at 31 December 2018	2,017	350,362	271	1,630	2,452	—	356,732
As at 1 January 2018	1,908	261,995	246	1,197	—	—	265,346

¹ Capitalised development expenditure on ADM™ units has been reallocated from IT development and software in intangible assets to meter assets within property, plant and equipment, to align with the Group's accounting policy.

Right-of-use assets have been recognised following the implementation of IFRS 16. Of the £4,889,000 additions reported above, £3,820,000 relates to right-of-use assets recognised upon implementation on 1 January 2019. See note 29 for further details.

Included within the closing meter assets net book value of £398,717,000 (2018: £350,362,000) is £30,298,000 (2018: £43,049,000) relating to the traditional meter portfolio. In accordance with our accounting policy these assets will be written down to zero by 2022. In the 2019 consolidated financial statements the traditional meter portfolio generated £12,965,000 (2018: £13,216,000) revenue with a corresponding £11,184,000 (2018: £4,682,000) depreciation charge. £13,928,000 (2018: £12,853,000) annualised recurring revenue as at 31 December 2019 arises from the traditional meter portfolio.

The assets are secured by a bond and floating charge (note 17).

For the purpose of impairment testing the traditional meter asset portfolio recognised within "meter assets" is assessed as a stand-alone cash-generating unit (CGU) and its carrying amount is compared with the recoverable amount. See background information provided in the "Key sources of estimation uncertainty" section in the accounting policies. The recoverable amount is determined based on a value in use calculation, which uses the following key assumptions:

- ▶ estimated future cash flows from rental income, which are assumed to decline on a straight line basis;
- ▶ estimated future cash flows from termination income, which are derived using historical data and analysis around the risk of churn between contracted and non-contracted customers and the risk of recoverability once issued; and
- ▶ a pre-tax discount rate of 2.65%, which reflects the risk attached to the time value of these specific cash flows and is deemed to be best represented by the Group's incremental cost of borrowing on the basis that cash flows are secured by the installed meter and the risk inherent in the decline of the cash flows is already accounted for through the assumptions detailed above.

As a result of this impairment test, it was identified that the value in use exceeded the carrying value of the traditional meter assets CGU and, therefore, no impairment has been recognised in the year to 31 December 2019. An impairment charge of £5.6m was recognised in the year to 31 December 2018.

10 Property, plant and equipment continued

Management has performed sensitivity analysis on the key assumptions both with other variables held constant and with other variables simultaneously changed. Management has concluded that there are no reasonably possible changes in the key assumptions that would cause the carrying amounts of the traditional meter portfolio to exceed the value in use for either CGU.

No impairment on other meter assets was recognised in 2019.

11 Financial asset investments

	Shares in Group undertaking £'000	Unlisted investments £'000	Total £'000
Cost			
As at 1 January 2019	—	75	75
Impairment	—	—	—
As at 31 December 2019	—	75	75

12 Impairment of goodwill

The goodwill acquired in business combinations is allocated, at acquisition, to the CGUs that are expected to benefit from that business combination. Goodwill is monitored by management at the level of the CGUs (defined as the three operating segments) identified in note 1.

A segment-level summary of the goodwill allocation is presented below:

	Asset management £'000	Asset installation £'000	Energy management £'000	Total £'000
Cost				
As at 1 January 2019	4,112	3,497	—	7,609
Acquisitions (note 19)	—	—	995	995
Exchange adjustments	—	—	(57)	(57)
As at 31 December 2019	4,112	3,497	938	8,547

The goodwill recognised in energy management in the year ended 31 December 2019 has arisen on the acquisition of Solo Energy Limited, a blockchain energy flexibility IT platform. See note 19 for further details. Goodwill was allocated entirely to energy management on the basis that this is the operating segment that will receive the benefits from the acquisition.

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. Goodwill is tested for impairment by comparing the carrying amount of each CGU, including goodwill, with the recoverable amount. The recoverable amounts are determined based on value in use calculations which require assumptions. The calculations use cash flow projections based on financial budgets approved by the Board covering a one-year period, together with management forecasts for a further four-year period. These budgets and forecasts have regard to historical performance and knowledge of the current market, together with the Group's views on the future achievable growth and the impact of committed cash flows. Cash flows beyond this are extrapolated using the estimated growth rates stated below.

The cash flows used in the value in use calculation for the asset management segment include all costs incurred in the provision of meter assets to energy suppliers, together with the initial installation. The cash flows used in the value in use calculation for the asset installation segment exclude installation costs incurred to fit an owned meter. For the purpose of the value in use calculation, these are instead allocated to the asset management segment, being the segment to which the corresponding revenues are allocated.

The annual impairment test was performed for the three CGUs identified above that have goodwill allocated to them. No evidence of impairment was found at the balance sheet date.

The key assumptions used in the value in use calculations for those CGUs that have goodwill allocated to them are as follows:

- **Perpetual growth rate** – the terminal cash flows are extrapolated in perpetuity using a growth rate of 3% for asset management (2018: 2.0%) and 0.5% for asset installation and energy management (2018: 2.0%). The rate of 3% applied to asset management is derived from historical Retail Price Index increases applied to the segment's index-linked meter rentals. This is not considered to be higher than the average long-term industry growth rate. The rate of 0.5% applied to asset installation and energy management is prudently aligned with the UK rate of inflation as revenues in these segments are not always index linked.
- **Discount rate** – the discount rate is initially based on the weighted average cost of capital (WACC) which would be anticipated for a market participant investing in the Group. A specific discount rate is then calculated for each operating segment, taking into account the time value of money, the segment's risk profile and the impact of the current economic climate. The pre-tax discount rates applied are 7.1%, 10.7% and 10.7% for asset management, asset installation and energy management respectively (2018: 7.2% for all three segments) and the post-tax discount rates applied are 5.9%, 8.9% and 8.9% for asset management, asset installation and energy management respectively (2018: 5.9% for all three segments).

For the year ended 31 December 2019

12 Impairment of goodwill continued

Management has performed sensitivity analysis on the key assumptions both with other variables held constant and with other variables simultaneously changed. Management has concluded that there are no reasonably possible changes in the key assumptions that would cause the carrying amounts of goodwill to exceed the value in use for either CGU.

13 Inventories

	2019 £'000	2018 £'000
Finished goods	21,734	10,728
Consumables	327	533
	22,061	11,261

There has been a significant increase in inventory, with the strategic purchasing of SMETS2 meters to ensure the Group can meet forecast installations in the first part of 2020.

14 Trade and other receivables

	2019 £'000	2018 £'000
Trade receivables	28,596	17,582
Prepayments	1,944	1,090
Accrued income	15,490	10,454
Other receivables	1,655	944
VAT recoverable	602	570
	48,287	30,640

Trade receivables and accrued income include billed and unbilled receivables relating to our meter rental contracts.

Amounts falling due after more than one year:

	2019 £'000	2018 £'000
Accrued income	232	402

Accrued income is made up of the following balances:

	2019 £'000	2018 £'000
Unbilled receivables	15,455	10,432
Contract assets	11	22
Other accrued income	24	—
	15,490	10,454

Unbilled receivables include receivables relating to our meter rental contracts.

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

The Group's credit risk is primarily attributable to trade receivables and accrued income. The amounts presented in the consolidated statement of financial position are net of any loss allowance. The total loss allowance for trade receivables and accrued income at 31 December 2019 was £4,413,000 (2018: £3,112,000). See note 18 for further details. The ageing profile of trade receivables past due date is shown below:

	2019 £'000	2018 £'000
31–60 days	6,623	1,761
61–90 days	2,228	1,662
Over 90 days	4,359	2,719
	13,210	6,142
Loss allowance	(4,284)	(2,356)
	8,926	3,786

14 Trade and other receivables continued

Trade receivables are non-interest bearing and are generally on 30–90-day terms. Trade receivables due from related parties at 31 December 2019 amounted to £Nil (2018: £Nil).

Receivables are all in Sterling denominations.

Accrued income, which is made up of unbilled receivables and contract assets, is presented net of any loss allowance and impairment, with amounts being invoiced periodically and customers being the same as those within trade receivables.

15 Cash and cash equivalents

Cash and cash equivalents comprise cash held by the Group. The carrying amount of the asset approximates the fair value. All balances are held in Sterling.

During each period, there were no amounts of cash placed on short-term deposit.

For the purposes of the cash flow statement, cash and cash equivalents comprises:

	2019 £'000	2018 £'000
Cash	50,092	30,027
	50,092	30,027

16 Trade and other payables

	2019 £'000	2018 £'000
Current		
Trade payables	16,466	13,835
Other payables	2,420	775
Other taxes	4,788	2,628
Deferred income	2,487	3,540
Advance payments	1,335	1,345
Accruals	19,300	14,225
	46,796	36,348

Deferred income and advance payments are made up of the following balances:

	2019 £'000	2018 £'000
Contract liabilities	3,494	3,229
Other deferred income	328	1,656
	3,822	4,885

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

Trade payables are classified at amortised cost, are non-interest bearing and are normally settled on 30–45-day terms.

All trade liabilities are denominated in Sterling.

17 Financial liabilities

	2019 £'000	2018 £'000
Current		
Lease liabilities	1,013	—
Bank loans	1,724	172,016
	2,737	172,016
Non-current		
Lease liabilities	2,950	—
Bank loans	267,536	—
	270,486	—

Bank loans at 31 December 2018 relate to a revolving credit facility of £280m.

For the year ended 31 December 2019

17 Financial liabilities_{continued}

On 21 December 2018, the Group entered into a new revolving credit facility agreement with a syndicate of banks for £420m, available for five years (the new facility). This new facility comprises a different banking structure, gives rise to a significant increase in the Group's borrowing capacity and discharged the Group's obligations under the previous facility with effect from the first utilisation on 3 January 2019. It is thus deemed to be an extinguishment.

On 3 January 2019, the first drawdown was made under the new facility for £200m. This was used to settle the Group's outstanding obligations under the previous facility of £172m and fund additional capital investment. The drawdown pattern changes under the new facility to quarterly in advance, rather than monthly in arrears. The balance of unamortised arrangement fees on the previous facility of £0.1m has been accelerated and recognised as an exceptional finance cost in the consolidated income statement for the year ended 31 December 2019.

Transaction costs on the new facility of £3.1m, deferred within other assets at 31 December 2018 and also recognised within other liabilities, were reclassified to bank loans on 3 January 2019 and are amortised over the term of the new facility. At 31 December 2019, £0.6m of transaction costs had been recognised within the consolidated income statement.

The Group had a total outstanding principal of £270m at 31 December 2019. Repayment of the principal is not required until 2022 under the terms of the contract and, therefore, this balance has been classified as non-current at 31 December 2019. Accrued interest of £1.7m has been recognised as part of the carrying value of bank loans at 31 December 2019 together with a deduction of £2.5m for unamortised transaction costs.

In 2019, the new facility attracted interest at a rate of 1.85% over the three-month LIBOR and 0.65% was payable on undrawn funds. The interest is required to be settled quarterly and has thus been classified as current at 31 December 2019.

The Group has complied with the financial covenants of its borrowing facility during the 2019 and 2018 reporting period.

Following the announcement on 12 March 2020 that the Group has signed an agreement to dispose of a minority of the Group's meter assets, as detailed in note 28(a), the Group intends to fully repay the existing debt facility in 2020 and replace it with an amended £300m revolving credit facility on the same terms.

17 (a) Changes in liabilities arising from financing activities

Financial liabilities	Lease liabilities £'000	Bank loans £'000
At 1 January 2018	—	187,084
Cash flows (i)	—	(15,654)
Other non-cash changes (i)	—	586
At 31 December 2018	—	172,016
Recognition on adoption of IFRS 16 (see note 29)	3,868	—
At 1 January 2019	3,868	172,016
Cash flows (i)	(1,075)	90,149
New leases	1,040	—
Other non-cash changes (i)	130	7,095
At 31 December 2019	3,963	269,260

(i) Cash flows and other non-cash changes

Cash flows lease liabilities include £1,075,000 of lease payments. Cash flows on bank loans include £270,000,000 of new borrowings less £172,114,000 of borrowings repaid, interest payments of £4,632,000 and a payment of £3,105,000 for arrangement fees.

Other non-cash changes in lease liabilities include £157,000 of interest charges less £27,000 arising from changes in lease terms in the year. Other non-cash changes in bank loans include £6,356,000 of interest charges, of which £1,724,000 were unpaid at 31 December 2019, and £739,000 amortisation of arrangement fees.

In 2018, cash flows on bank loans included £101,627,000 of new borrowings less £117,281,000 of borrowings repaid. Other non-cash changes in bank loans included £586,000 amortisation of arrangement fees.

18 Financial risk management

The Board reviews and agrees policies for managing the risks associated with interest rate, credit and liquidity risk. The Group has in place a risk management policy that seeks to minimise any adverse effect on the financial performance of the Group by continually monitoring the following risks:

18 (a) Interest rate risk

The Group's main interest rate risk arises from its floating rate bank loan of £269,260,000 (2018: £172,016,000). See note 17 for further details.

There were no overdrafts at 31 December 2019 (2018: none) and the interest charge arising on lease liabilities, recognised from 1 January 2019 upon implementation of IFRS 16, does not represent a cash interest rate risk for the Group.

The Group's financial assets at 31 December 2019 comprise cash and trade receivables. The cash balance of £50,092,000 (2018: £30,027,000) is a floating rate financial asset but interest income is not typically material.

18 Financial risk management continued

18 (a) Interest rate risk continued

(i) Interest rate sensitivity

The following table demonstrates the sensitivity to a change in interest rates on the Group's floating rate bank loan. The Group's profit before tax is affected through the impact on floating rate borrowings as follows:

	Increase/decrease in basis points	Effect on profit before tax £'000
2019	+70bps	(1,885)
2018	+70bps	(1,204)

Management believes that a movement in interest rates of 70bps gives a reasonable measure of the Group's sensitivity to interest rate risk. The table above demonstrates the sensitivity to a possible change in interest rates, with all other variables held constant, of the Group's profit before tax.

18 (b) Fair values of financial liabilities and financial assets

The Group's bank loan is measured at amortised cost. For fair value disclosure purposes, the bank loan is considered to be a level 2 financial instrument on the basis that it is not traded in an active market. The fair values, based upon the market value or discounted cash flows of financial liabilities and financial assets held in the Group, were not materially different from their book values.

18 (c) Foreign currency risk

The Group's exposure to the risk of changes in foreign exchange primarily arises from a single subsidiary acquired during the year, operating in Euros. With the exception of this entity, all of the Group's operating activities are denominated in Pounds Sterling and, therefore, the Group's overall exposure is not significant.

18 (d) Liquidity risk

The Group manages its cash in a manner designed to ensure maximum benefit is gained whilst ensuring security of investment sources. The Group's policy on investment of surplus funds is to place deposits at institutions with strong credit ratings; this is considered to be institutions with a credit rating of AA- and above. Currently, all of the chosen investment institutions are in line with these criteria.

The ageing and maturity profile of the Group's material financial liabilities is disclosed in the table below. The amounts disclosed are the contractual undiscounted cash flows.

	Less than one year £'000	Between two and five years £'000	Over five years £'000	Total contractual cash flows £'000
31 December 2019				
Contractual maturities of financial liabilities				
Trade payables	16,466	—	—	16,466
Bank loan	7,049	290,954	—	298,003
Lease liabilities	1,153	2,748	456	4,357
	24,668	293,702	456	318,826

The contractual undiscounted cash flows on the bank loan reflect the contractual arrangements in place at 31 December 2019. As disclosed in note 28(a), the Group intends to fully repay the existing debt facility in 2020. Of the £290,954,000 disclosed in the 2019 bank loan time band "between two and five years", the Group has assumed that the entire principal balance will be settled upon maturity of the loan facility at the end of 2023.

	Less than one year £'000	Between two and five years £'000	Over five years £'000	Total contractual cash flows £'000
31 December 2018				
Contractual maturities of financial liabilities				
Trade payables	13,835	—	—	13,835
Bank loan ¹	172,016	—	—	172,016
Lease liabilities	—	—	—	—
	185,851	—	—	185,851

¹ In 2018, there was a nil variable interest rate impact given the full loan balance at 31 December 2018 was considered short term and was extinguished on 3 January 2019.

18 (e) Credit risk

The Group's credit risk primarily arises from credit exposures to energy suppliers (our customers), including outstanding receivables, due to the Group trading with a limited number of companies, which are generally large utility companies or financial institutions.

For the year ended 31 December 2019

18 Financial risk management continued

18 (e) Credit risk continued

Credit risk is managed on a Group basis. For banks and financial institutions, only independently rated parties with a minimum rating of "AA-" are accepted. With regard to customers, the Group assesses the credit quality of the customer, considering its financial position, past experience and other factors. The Group does not expect, in the normal course of events, that debts due from customers are at significant risk.

The Group's maximum exposure to credit risk equates to the carrying value of cash and cash equivalents, trade and other receivables, contract assets and investments. The Group's maximum exposure to credit risk from its customers is £44,318,000 (2018: £28,438,000) being the sum of the carrying value of trade receivables and accrued income, including contract assets, as disclosed within trade and other receivables in note 14. The Group regularly monitors and updates its cash flow forecasts to ensure it has sufficient and appropriate funds to meet its ongoing operational requirements.

(i) Impairment of financial assets

The Group has two types of financial assets that are subject to IFRS 9's expected credit loss model:

- ▶ trade receivables, which consist of billed receivables arising from contracts with customers, for the provision of meter asset installation, management and energy services; and
- ▶ accrued income, which consists of contract assets and unbilled receivables arising from contracts with customers.

While cash and cash equivalents, and debt investments held at amortised cost, are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

The Group applies the IFRS 9 simplified approach to measuring forward-looking expected credit losses (ECL) which uses a lifetime expected loss allowance for all trade receivables and accrued income, including contract assets.

To measure the ECL, trade receivables and accrued income have been grouped based on shared credit risk characteristics and the days past due. Accrued income relates to rights to consideration for performance, and other operating charges, before payment is due from customers and consists of unbilled receivables and contract assets (see note 2 for details). These have substantially the same risk characteristics as the trade receivables for the same types of contracts. The Group has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for accrued income.

The Group has established a provision matrix based on the payment profiles of sales, over the most recent twelve-month period that is an appropriate representation of loss patterns, and the corresponding historical credit losses experienced within this period. The historical loss rates are adjusted to reflect current and forward-looking information that might affect the ability of customers to settle the receivables, including macroeconomic factors as relevant. In calculating the loss rates, certain historical losses arising from specific circumstances with customers have been removed where these are not indicative of future loss patterns.

On that basis, the loss allowance at 31 December 2019 was determined as £4,413,000 (31 December 2018: £3,112,000) for trade receivables and accrued income. A reconciliation of these balances is provided as follows:

	Accrued income £'000	Trade receivables £'000	Total £'000
At 1 January 2019	756	2,356	3,112
(Decrease)/increase in loss allowance recognised in profit or loss during the year	(627)	4,012	3,385
Receivables written off during the year as uncollectable	—	(2,084)	(2,084)
Unused amount reversed	—	—	—
At 31 December 2019	129	4,284	4,413

Total trade receivables have increased since the prior year end, contributing to the increase in loss allowance recognised at 31 December 2019. In addition, the loss allowance at 31 December 2019 includes certain individually impaired trade receivables as a result of specific circumstances with customers. The decrease in the loss allowance on accrued income reflects the application of updated loss rates and an overall decrease in accrued termination income as compared with the prior year. Total net impairment losses on financial and contract assets were £3,385,000 in 2019 (2018: £2,409,000). Of this amount, £3,385,000 (2018: £2,366,000) relates to amounts arising from trade receivables and accrued income.

(ii) Fair value

There is no material difference between the book value and the fair value of any financial asset or liability.

18 (f) Capital management

Capital is the equity attributable to the equity holders of the parent. The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value. The Group manages its capital structure, and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, sell assets, return capital to shareholders or issue new shares.

The Group monitors capital on the basis of a leverage ratio. This ratio is calculated as net debt divided by pre-exceptional EBITDA. Net debt is calculated as total borrowings less cash. Pre-exceptional EBITDA is calculated as operating profit before any significant exceptional items, interest, tax, depreciation and amortisation.

18 Financial risk management continued

18 (f) Capital management continued

The objective of SMS's strategy is to deliver long-term value to its shareholders whilst maintaining a balance sheet structure that safeguards the Group's financial position. From an ordinary dividend perspective our objective has been to provide a progressive, through-cycle dividend that reflects the potential volatility of our business. A revised dividend policy has been proposed, effective in 2020, following the disposal of a minority of the Group's meter assets. See note 28(a) for further details.

19 Business combinations

On 5 September 2019 the Group acquired 100% of the issued share capital of Solo Energy Limited (company number 566746), a blockchain energy flexibility IT platform. The acquisition will enable SMS to utilise Solo's IT platform, which was still under development at 31 December 2019, to establish new long-term revenue streams from a decentralised energy grid.

The company's registered office address is Phoenix House, Monahan Road, Cork T12 H1XY, and it reports in Euros.

Purchase consideration consisted of cash only. Total cash paid was 1,152,000 EUR (equivalent to £1,032,000 using an exchange rate of 1.1163 at 5 September 2019).

The assets and liabilities recognised as a result of the acquisition are as follows:

	Fair value £'000 ¹
Intangible assets: capitalised development	697
Intangible assets: trademarks	96
Plant and equipment	6
Cash and cash equivalents	5
Trade and other receivables	4
Trade and other payables	(230)
Deferred income: government grants	(24)
Borrowings	(334)
Deferred tax liability	(16)
Net identifiable assets acquired	204
Less: pre-existing relationship	(167)
Add: goodwill	995
Net assets acquired	1,032

¹ All net assets acquired have been translated using an exchange rate of 1.1163 at 5 September 2019.

No contingent assets or liabilities were acquired.

In addition to the borrowings acquired above of £334,000 Solo Energy Limited had a short-term loan of £167,000 due to an SMS subsidiary company at the date of acquisition. In accordance with IFRS 3, this pre-existing relationship is accounted for as "effectively" settled on acquisition by increasing the consideration transferred for the acquisition. The acquisition of Solo Energy Limited and the effective settlement of the receivable are recorded as separate transactions. No gain or loss has been recognised as the receivable due from Solo Energy Limited was effectively settled at the recorded amount.

The goodwill is attributable to management expertise and the new, long-term revenue opportunities expected from the deployment of Solo Energy's IT platform. Goodwill will not be deductible for tax purposes.

The IT platform acquired was still under development at 31 December 2019. Therefore, for the period from 5 September to 31 December 2019, the acquired business contributed immaterial revenues and a net loss before taxation of £120,000 to the Group. If the acquisition had occurred on 1 January 2019, consolidated pro-forma revenue for the year ended 31 December 2019 would also have been immaterial and consolidated pro-forma loss for the year ended 31 December 2019 would have been approximately £384,000. No further adjustments were required as there were no material differences in the accounting policies between the Group and the entities acquired.

Acquisition related costs of £92,000 were incurred and are included as part of exceptional administrative costs in the consolidated statement of comprehensive income.

There were no acquisitions in the year ending 31 December 2018.

For the year ended 31 December 2019

20 Deferred taxation

The movement in the deferred taxation liability during the period was:

	2019 £'000	2018 £'000
Opening deferred tax liability	12,070	9,924
Increase in provision through consolidated statement of comprehensive income	1,544	1,052
Increase/(decrease) in provision through equity	149	1,094
Deferred tax on intangibles acquired as part of acquisitions	16	—
Closing deferred tax liability	13,779	12,070

The Group's provision for deferred taxation consists of the tax effect of temporary differences in respect of:

	2019 £'000	2018 £'000
Excess of taxation allowances over depreciation on property, plant and equipment	11,691	12,170
Tax losses available	(1)	(96)
Deferred tax asset on share options	(992)	(1,056)
Deferred tax on intangibles acquired	58	147
Other	3,023	905
	13,779	12,070

The deferred tax included in the consolidated statement of comprehensive income is as follows:

	2019 £'000	2018 £'000
Accelerated capital allowances	(478)	613
Tax losses	95	(35)
Deferred tax asset on share options	(85)	(152)
Movement in fair value of intangibles	(106)	(280)
Other	2,118	906
	1,544	1,052

The Group had unrecognised tax losses of £763,000 in a subsidiary undertaking at 31 December 2019.

The main rate of corporate taxation is expected to reduce from 19% to 17% effective 1 April 2020, as a result of the Finance Act 2016, which was substantively enacted on 6 September 2016. Consequently, deferred tax has been provided at the tax rates at which temporary differences are expected to reverse.

21 Related party transactions

21 (a) Subsidiaries

The Group's subsidiaries at 31 December 2019 are set out below. Unless otherwise stated, they have share capital consisting solely of ordinary shares, and the proportion of ownership interests held equals the voting rights held by the Group. The country of registration is also their principal place of business.

	Registered office	Holding	Proportion of shares held	Nature of business
SMS Connections Limited	1	Ordinary shares	100%	Gas utility connections
SMS Meter Assets Limited	1	Ordinary shares	100%	Gas and electric asset management
SMS MAPCO 1 Limited	1	Ordinary shares	100%	Gas and electric asset management
Crail Meters Limited**	1	Ordinary shares	100%	Gas and electric asset management
SMS Data Management Limited	1	Ordinary shares	100%	Data management
UKMA (AF) Limited*	2	Ordinary shares	100%	Funding
SMS Corporate Services Limited‡	1	Ordinary shares	100%	Administrative services
SMS Energy Services Limited	2	Ordinary shares	100%	Electricity utility connections and management
CH4 Gas Utility and Maintenance Services Limited*	2	Ordinary shares	100%	Meter installation
SMS Utilities Academy Limited**	2	Ordinary shares	100%	Engineer training and development
Trojan Utilities Limited*	2	Ordinary shares	100%	Meter installation
Qton Solutions Limited*	2	Ordinary shares	100%	Business and domestic software development
Solo Energy Limited (UK)**	1	Ordinary shares	100%	Renewable asset management
Solo Energy Limited (Ireland)**	3	Ordinary shares	100%	Renewable asset management

* The shareholding in this company is indirect via a subsidiary company.

‡ Newly incorporated entity in 2019.

1 Registered office address: 2nd Floor, 48 St. Vincent Street, Glasgow G2 5TS.

2 Registered office address: Prennau House, Copse Walk, Cardiff Gate Business Park, Cardiff CF23 8XH.

3 Registered office address: Phoenix House, Monahan Road, Cork T12 HIXY.

21 (b) Key management personnel compensation

The Group has determined that key management personnel constitute the Executive Directors, Non-executive Directors and certain senior management personnel. The aggregate compensation paid or payable to key management is shown below:

	2019 £'000	2018 £'000
Short-term employee benefits	1,557	2,369
Post-employment benefits	22	23
Share-based payments	186	114
	1,765	2,506

21 (c) Directors

(i) Directors' emoluments

Aggregate remuneration for both Executive and Non-executive Directors in respect of qualifying services was:

	2019 £'000	2018 £'000
Aggregate emoluments	877	1,281
Company contributions to money purchase pension scheme	11	8
Company contributions to private pension plan	—	—
	888	1,289

In 2019, no amount was payable to Directors as settlements following resignation (2018: no amount was payable to Directors).

Detailed remuneration disclosures are also provided in the Remuneration Report on pages 63 to 70.

(ii) Emoluments of highest paid Director

	2019 £'000	2018 £'000
Emoluments	377	663

In addition, rent was paid into the highest paid Director's personal pension scheme. See note 21 (d) for further details.

For the year ended 31 December 2019

21 Related party transactions continued**21 (c) Directors** continued**(iii) Number of Directors who accrued benefits under Company pension schemes**

	2019 Number	2018 Number
Money purchase schemes	2	1

21 (d) Other transactions with related parties

A number of key management personnel hold positions in other entities that result in them having control or significant influence over the financial or operating policies.

A number of these entities transacted with the Group in the reporting period. The terms and conditions of the transactions with key management personnel and their related parties were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-key management personnel and related entities on an arm's length basis.

During the period, the Group entered into the following transactions with related parties:

- ▶ Rent amounting to £41,500 (2018: £41,615) paid to the Directors' pension scheme, Eco Retirement Benefit Scheme, for the use of certain premises. Alan Foy is a trustee of the scheme. At the year-end date, an amount of £Nil (2018: £Nil) was outstanding in this regard.
- ▶ The Group paid dividends to Alan Foy of £281,382 (2018: £244,641), The Metis Trust¹ of £56,520 (2018: £49,140), David Thompson of £84 (2018: £27), Miriam Greenwood of £1,046 (2018: £893), Willie MacDiarmid² of £372 (2018: £323), Graeme Bissett of £333 (2018: £289) and Tim Mortlock of £121 (2018: £Nil).
- ▶ During the year, SMS Utilities Academy Limited purchased a group of assets and liabilities for £27,500 from Utilities Academy Limited – a third-party smart meter training facility in which another subsidiary undertaking, Trojan Utilities Limited, had a minority shareholding. The net assets purchased were previously used by Utilities Academy Limited in its business of providing training to dual fuel smart meter engineers on behalf of third-party customers. Utilities Academy Limited went into administration on 28 March 2019, at which point the cost of Trojan Utilities Limited's minority investment in the company was written off. At 31 December 2018 Trojan Utilities Limited had a balance with Utilities Academy Limited of £26,442 with transactions during the year amounting to £Nil.

1 Alan Foy is a trustee but not a beneficiary.

2 Paid to a connected person.

22 Share capital

	2019 £'000	2018 £'000
Allotted and called up:		
112,811,122 ordinary shares of £0.01 each (2018: 112,548,050 ordinary shares of £0.01 each)	1,128	1,125

During the year 125,519 (2018: 97,250) ordinary share options were exercised in relation to the Group's employee share plans which are described in note 23. The ordinary shares issued have a nominal value of £1,000 (2018: £1,000) and aggregate consideration of £419,000 (2018: £270,000) was received.

In addition, 137,553 shares were issued during the year (2018: nil) in relation to deferred remuneration arising on the acquisition of a subsidiary in 2016, settled in shares in April 2019. The ordinary shares issued have a nominal value of £2,000 and a fair value of £829,000. No consideration was received for these shares. The total fair value of £829,000 has been recognised directly within retained earnings and the difference between the fair value and nominal value of £827,000 has been recognised within share premium.

The Group's Share Incentive Plan is administered by the Smart Metering Systems SIP Trust (the trust), which acquires shares in SMS (own shares) to satisfy awards under this plan and facilitate the delivery of shares to participants. At 31 December 2019, 146,412 (2018: 111,307) own shares were held in trust with a carry value of £768,000 (2018: £588,000) and a market value of £827,000 (2018: £584,000). The Company purchased 67,220 shares (2018: 36,137) from the market during 2019 with a weighted average fair value of £5.20 per share (2018: £6.34).

23 Share-based payments

23 (a) Employee option plans

On 20 June 2011 the Company adopted both the Approved Company Share Option Plan (CSOP) and the Unapproved Share Option Plan (the Unapproved Plan).

The CSOP is open to any employee of any member of the Group up to a maximum value of £30,000 per employee. The Unapproved Plan is open to any employee, including Executive Directors, of the Company or any other Group company who is required to devote substantially the whole of their time to their duties under his contract of employment.

Under the plans, participants are granted options which, except in certain specified circumstances, only vest if certain performance conditions are met and the employee is still in service within five years of the date of grant. The performance conditions for awards are based on market capitalisation and individual performance targets. Once vested, the options remain exercisable for a period of up to ten years from the date of grant. The exercise price of the options is determined by the Directors but shall not be less than the closing price at which the Company's shares are traded on the date of grant.

(i) Summary of options

The table below summarises options granted under the CSOP and Unapproved Plan:

Plan	At 1 January 2019	Granted	Exercised	Forfeited	Expired	At 31 December 2019	Exercise price (pence)	Date exercisable	Expiry date	Fair value at grant (pence)
CSOP	27,253	—	(1,400)	—	—	25,853	76.0	15 Jul 2014	15 Jul 2021	17.1
Unapproved	321,666	—	—	—	—	321,666	60.0	20 Jun 2016	20 Jun 2021	13.0
Unapproved	405,000	—	(25,000)	—	—	380,000	153.5	28 May 2017	28 May 2022	40.0
Unapproved	65,000	—	—	(25,000)	—	40,000	350.0	12 Nov 2019	12 Nov 2024	84.8
Unapproved	698,019	—	(22,544)	(15,693)	(1,904)	657,878	350.0	12 Nov 2019	12 Nov 2024	84.8
Unapproved	161,724	—	(76,575)	(51,050)	—	34,099	391.8	20 Mar 2021	19 Mar 2026	61.5
Unapproved	38,586	—	—	—	—	38,586	410.0	4 Jul 2021	3 Jul 2026	114.3
Unapproved	90,706	—	—	—	—	90,706	470.0	18 Aug 2021	17 Aug 2026	87.2
Unapproved	100,000	—	—	—	—	100,000	529.0	1 Sep 2021	31 Aug 2026	141.5
Unapproved	50,000	—	—	—	—	50,000	529.0	26 Sep 2021	25 Sep 2026	142.4
Unapproved	9,091	—	—	—	—	9,091	550.0	28 Nov 2021	28 Nov 2026	141.0
Unapproved ¹	489,001	—	—	(10,000)	—	479,001	700.0	1 Jan 2023	13 Jul 2028	125.2
Unapproved ³	12,000	—	—	—	—	12,000	602.8	13 Sep 2023	12 Sep 2028	154.3
Unapproved ²	—	489,000	—	(10,000)	—	479,000	700.0	1 Jan 2023	13 Jul 2028	34.6
Unapproved ³	—	12,000	—	—	—	12,000	602.8	13 Sep 2023	12 Sep 2028	98.0
Unapproved	—	370,000	—	—	—	370,000	454.6	5 Sep 2024	4 Sep 2029	111.5
Total	2,468,046	871,000	(125,519)	(111,743)	(1,904)	3,099,880				

1 Options of 489,001 relate to the first of five tranches. Remaining tranches will be granted in line with plan rules.

2 Options of 489,000 relate to the second of five tranches. Remaining tranches will be granted in line with plan rules.

3 Options of 12,000 and 12,000, respectively, relate to the first and second of five tranches. Remaining tranches will be granted in line with plan rules.

The weighted average share price at the date of exercise of options exercised during the year ended 31 December 2019 was £5.39 (2018: £7.59).

(ii) Fair value of options granted

The assessed fair value at the valuation date of options granted during the year ended 31 December 2019 ranged from 34.6p to 111.5p, as disclosed in the table above (2018: 125.2p to 154.3p). The fair value of options granted is estimated using appropriate option pricing models, taking into account the exercise price, the term of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield, the risk-free rate interest rate for the term of the option, and the market-based performance conditions. The expected price volatility is based on historical volatility, adjusted for any expected changes to future volatility due to publicly available information.

The total fair value of these options is recognised over the period from their grant date until they become exercisable.

For the year ended 31 December 2019

23 Share-based payments continued**23 (a) Employee option plans** continued**(ii) Fair value of options granted** continued

The following table lists the range of assumptions applied to the options granted under the Unapproved Plan during the year ended 31 December 2019:

Dividend yield (%)	1.00 to 1.37
Expected volatility (%)	30.32 to 30.55
Risk-free interest rate (%)	0.43 to 0.60
Expected option life (years)	4.04 to 5.00
Exercise price (£)	4.55 to 7.00
Share price at grant date (£)	4.64 to 5.31
Fair value at grant date (£)	0.35 to 1.12

Where the options granted have a market performance condition attached, the Group has used a Monte Carlo model in order to allow for the impact of this condition. Where there is no market performance condition attached, the Group has used the traditional Black-Scholes model. The dividend yield was determined using the published yield at the date of grant. The expected volatility reflects the assumption that historical volatility, as measured over several different periods, is indicative of future trends, which may not necessarily be the actual outcome. The risk-free interest rate is taken from a government bond yield rate with a redemption period consistent with the corresponding vesting period of the options. The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur.

The expense recognised in 2019 for all options is £353,000 (2018: £282,000).

23 (b) Share Incentive Plan (SIP)

The Company introduced the SIP in October 2014. All employees of the Group (including Executive Directors) are eligible to participate in the SIP. Participants may each acquire Partnership Shares worth up to £1,800 per year from their pre-tax earnings at market value. The Company awards participants one Matching Share for each Partnership Share which they acquire. Dividends received on shares held in the SIP are reinvested to acquire Dividend Shares at market value. Matching Shares may be forfeited if the participant disposes of the corresponding Partnership Shares or leaves the employment of the Group within three years of the award date.

The table below shows the number of shares held in the SIP at the beginning and end of the year.

Type of award	At 1 January 2019	Awarded shares	Sold/transferred	Forfeited	At 31 December 2019	Weighted average acquisition price
Partnership	158,961	71,145	(26,776)	(83)	203,247	£5.25
Matching	157,624	71,145	(13,216)	(14,638)	200,915	£5.25
Dividend	3,617	5,302	(617)	(12)	8,290	£5.47
Total	320,202	147,592	(40,609)	(14,733)	412,452	

The SIP is administered by the Smart Metering Systems SIP Trust. To the extent sufficient shares are not already held by the trust, Matching Shares awarded by the trust to employees are acquired on market prior to the award. Matching Shares held by the trust, which have not yet vested unconditionally at the end of the reporting period, are shown as own shares in the financial statements.

The fair value of the Matching Shares at the award date is equal to the share price at the award date. The weighted average fair value per share of the Matching Shares awarded during 2019 was approximately £5.26 per share (2018: £6.56). The total fair value of Matching Shares awarded is recognised over the three-year period starting on the respective award dates.

The expense recognised in 2019 for all Matching Shares is £250,000 (2018: £206,000). No expense is recognised for the Partnership Shares and Dividend Shares because the participants pay full market value for these shares.

24 Other reserve

This is a non-distributable reserve that initially arose by applying merger relief under section 612 of the Companies Act 2006 to the shares issued in 2009 in connection with the Group restructuring. Additionally, the premium of £4,189,000 and £1,115,000 arising on the issue of shares as part of the acquisitions of CH4 Gas Utility and Maintenance Services Limited (CH4), Trojan Utilities Limited (Trojan) and Qton Solutions Limited (Qton) has been credited to this reserve.

25 Commitments under operating leases

The Group's commercial leases for certain vehicles, office and warehouse space are accounted for under IFRS 16 with effect from 1 January 2019 and are thus excluded from the below operating lease commitments disclosure in 2019. These were previously included in the prior year. See note 29 for further details on the implementation of IFRS 16.

2019 commitments under operating leases include the Group's commercial leases for its fleet vans and items of office equipment. These leases are either short term (the contract term is less than twelve months) or low value (underlying asset less than \$5,000) and, therefore, meet the exemption criteria under IFRS 16. They continue to be expensed through the consolidated statement of comprehensive income. These leases have lives between one and three years and some have renewal options included in the contracts. There are no restrictions placed upon the Group by entering into these leases.

25 Commitments under operating leases continued

Future minimum rentals payable under non-cancellable operating leases as at each year end are as follows:

	2019 £'000	2018 £'000
Future minimum commitments under operating lease agreements are as follows:		
Payable within one year	61	1,258
Payable within two and five years	19	2,841
Payable after five years	—	861
	80	4,960

26 Capital commitments

Significant capital expenditure contracted for at the end of the reporting period but not recognised as liabilities is as follows:

	2019 £'000	2018 £'000
Property, plant and equipment	579	—
Intangible assets	1,233	2,430

Included within the capital expenditure on intangible assets is £1,041,000 (2018: £2,430,000) in relation to the implementation of a new ERP system across the Group.

27 Ultimate controlling party

There is no ultimate controlling party by virtue of the structure of shareholdings in the Group.

28 Post balance sheet events

28 (a) Sale of a minority of meter assets

As announced on 12 March 2020, the Group has signed an agreement to dispose of a minority of the Group's meter assets for a total gross cash consideration of £291m. Following the deduction of transaction and other expenses, and subject to completion of the disposal (which is expected to take place on 22 April 2020), the Group expects to receive net cash consideration of £282m.

The meters being disposed of have a net book value of £89m at 31 December 2019 and the transaction is expected to result in a gain of approximately £193m, which will be disclosed as an exceptional item in the financial statements. The disposal will be effected by the sale of the entire share capital of Crail Meters Limited, a wholly owned subsidiary of the Group.

SMS will continue to manage the disposed meter portfolio on behalf of the purchaser, for which it will receive RPI-linked management fees of £0.8m in the first full year.

The Group also announced a revised dividend policy, with a proposed annual dividend of 25p per share for FY2020 increasing at least in line with RPI until FY2024, and a scrip alternative offer for up to 30% of the dividend.

Linked to this transaction, the Group intends to fully repay the existing debt facility and replace it with an amended £300m revolving credit facility on the same terms.

28 (b) Budget 2020 announcement

Deferred tax has been provided on the consolidated balance sheet at 31 December 2019 at a rate of 17%; being the rate which was substantively enacted at the balance sheet date (effective 6 September 2016). The Budget 2020, announced on 11 March 2020, has confirmed that the decrease from 19% to 17%, previously due to become effective from 1 April 2020, will no longer occur once draft legislation is passed. The impact of this change would result in an increase to closing deferred tax liabilities of £1.6m.

28 (c) Coronavirus

As the situation continues to evolve, our primary concern is for the welfare of our people. We are following the development of the coronavirus outbreak and have implemented several immediate measures to protect our employees and to prepare for possible consequences of the virus. Whilst the outbreak has not yet had any direct impact on our operations, it is unclear how it will develop. It is currently difficult to assess the potential impact this could have on our 2020 business activities and results but, based on the current financial position of the Group, together with the cash that will be generated upon completion of the asset disposal detailed in note 28(b), we are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. We will continue to follow developments closely and are prepared to take further action as appropriate.

29 Impact of change in accounting policies on the financial statements

This note explains the impact of the adoption of IFRS 16 Leases on the Group's financial statements and discloses the new accounting policies that have been applied from 1 January 2019 in note 29 (b) below.

The Group has adopted IFRS 16 retrospectively from 1 January 2019 but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019.

For the year ended 31 December 2019

29 Impact of change in accounting policies on the financial statements^{continued}

29 (a) Adjustments recognised on adoption of IFRS 16

The change in accounting policy affected the following items in the consolidated balance sheet on 1 January 2019:

- ▶ right-of-use assets – increased by £3,820,000, recognised within property, plant and equipment;
- ▶ lease liabilities – increased by £3,868,000 (of which £3,173,000 were non-current), recognised separately on the consolidated balance sheet; and
- ▶ prepayments and accruals – decreased by £140,000 and £187,000 respectively.

On adoption of IFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as “operating leases” under the principles of IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee’s incremental borrowing rate as of 1 January 2019. The weighted average lessee’s incremental borrowing rate applied to the lease liabilities on 1 January 2019 and 31 December 2019 was 4%.

There was no net impact to retained earnings on 1 January 2019 and thus no impact to taxation on transition.

For the year ended 31 December 2019 there has been no material impact on operating profit or EBITDA but a portion of expense previously recognised within administrative expenses has been recognised as a finance cost under IFRS 16.

The Group had no leases previously classified as finance leases at 1 January 2019.

Differences between the operating lease commitments disclosed at 31 December 2018, discounted using the incremental borrowing rate at the date of initial application of IFRS 16, and the lease liabilities recognised in the consolidated balance sheet at 1 January 2019 comprise adjustments for prepayments and rent-free periods together with short-term and low-value leases recognised on a straight line basis as administrative expenses.

The associated right-of-use assets for leases were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet as at 31 December 2018. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets at the date of initial application.

The recognised right-of-use assets relate to the following types of assets:

	At 31 December 2019 £'000	At 1 January 2019 £'000
Cost		
Properties ¹	3,845	3,806
Motor vehicles	19	14
Total right-of-use assets	3,864	3,820

¹ Properties include office and warehouse space.

(i) Impact on segment disclosures and earnings per share

The asset management EBITDA, segment assets and segment liabilities for December 2019 all increased as a result of the change in accounting policy.

Lease liabilities and corresponding right-of-use assets are now included in the asset management segment liabilities and assets to the extent they relate to properties (i.e. warehouses) and motor vehicles directly attributable to the provision and management of meter assets.

	Segment assets at 31 December 2019 £'000	Segment liabilities at 31 December 2019 £'000
Asset management impact	905	893

All other right-of-use assets relate to corporate assets that are not allocated to a segment.

The increase in EBITDA and EPS was not material for the year ended 31 December 2019.

(ii) Practical expedients applied

In applying IFRS 16 for the first time, the Group has used the following practical expedients permitted by the standard:

- ▶ the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- ▶ reliance on previous assessments on whether leases are onerous;
- ▶ the accounting for operating leases with a remaining lease term of less than twelve months as at 1 January 2019 as short-term leases;
- ▶ the exclusion of initial direct costs for the measurement of the right-of-use asset at the date of initial application; and
- ▶ the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

29 Impact of change in accounting policies on the financial statements continued

29 (b) The Group's leasing activities and how these are accounted for

(i) Group as lessor

Under IAS 17 it was concluded that the Group acts as a lessor in its arrangements to provide meter assets to energy suppliers. These leases were classified as operating leases as the Group did not transfer substantially all the risks and rewards of ownership of the meter assets. The related meter income was recognised on a straight line basis per the meter rental income policy.

As a result of the Company's assessment of contracts on implementation of IFRS 16, the arrangements the Group has in place to act as meter asset provider were reconsidered and it was determined that the contract does not constitute a lease of the meter asset to the energy supplier. SMS controls the meter as the Group retains legal title and obtains substantially all the economic benefit. The assets are recognised as property, plant and equipment when in use under contract with an energy supplier and related income for the service of providing a fitted meter is recognised in accordance with IFRS 15. Further information about the Group's accounting policy for revenue recognition is given in note 2 and for property, plant and equipment in note 10.

There is no impact on the recognition and measurement of income earned from the provision of meter assets as a result of this change.

(ii) Group as a lessee

The Group leases various offices, warehouses and motor vehicles. Rental contracts are typically made for fixed periods of three to ten years but may have extension or early termination options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants, but leased assets may not be used as security for borrowing purposes.

Until 1 January 2019, leases of property, plant and equipment were classified as either finance or operating leases and, as at 1 January 2019, all leases were classified as operating leases. Payments (net of any incentives received from the lessor) were charged to profit or loss on a straight line basis over the period of the lease.

From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight line basis.

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- ▶ fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- ▶ variable lease payments that are based on an index or a rate;
- ▶ amounts expected to be payable by the lessee under residual value guarantees;
- ▶ the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- ▶ payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

- ▶ the amount of the initial measurement of lease liability;
- ▶ any lease payments made at or before the commencement date less any lease incentives received;
- ▶ any initial direct costs; and
- ▶ restoration costs.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight line basis as an expense in profit or loss. Short-term leases are leases with a lease term of twelve months or less. Low-value assets comprise IT equipment and small items of office furniture, where the value of the asset on inception is less than c.US\$5,000.

Payments for services are separated from the lease components of a contract and accounted for as an administrative expense.

As at 31 December 2019

	Notes	2019 £'000	2018 £'000
Fixed assets			
Investments	2	20,227	19,784
Current assets			
Debtors	3	163,978	156,690
Creditors			
Amounts falling due within one year	4	—	(627)
Net current assets		163,978	156,063
Total assets less current liabilities		184,205	175,847
Capital and reserves			
Called up share capital	6	1,128	1,125
Share premium account		160,106	158,861
Other reserves	7	13,968	13,297
Own share reserve		(768)	(588)
Profit and loss account		9,771	3,152
Equity shareholders' funds		184,205	175,847

No profit and loss account is presented by the Company as permitted by section 408 of the Companies Act 2006. The profit after taxation dealt with in the financial statements of the Company was £14,696,000 for the financial year ended 31 December 2019 (2018: £795,000).

The parent company financial statements on pages 120 to 124 were approved and authorised for issue by the Board of Directors and signed on its behalf by:

DAVID THOMPSON

Director

17 March 2020

COMPANY REGISTRATION NUMBER

SC367563

For the year ended 31 December 2019

Attributable to the owners of the parent company	Share capital £'000	Share premium account £'000	Other reserves £'000	Own share reserve £'000	Retained earnings £'000	Total £'000
As at 1 January 2018	1,124	158,592	12,089	(697)	8,839	179,947
Total comprehensive income for the year	—	—	—	—	795	795
Transactions with owners in their capacity as owners						
Dividends (note 8)	—	—	—	—	(6,143)	(6,143)
Share-based payments (note 7)	—	—	1,208	—	—	1,208
Movement in shares held by Share Incentive Plan	—	—	—	109	(339)	(230)
Shares issued	1	269	—	—	—	270
As at 31 December 2018	1,125	158,861	13,297	(588)	3,152	175,847
Total comprehensive income for the year	—	—	—	—	14,696	14,696
Transactions with owners in their capacity as owners						
Dividends (note 8)	—	—	—	—	(7,079)	(7,079)
Share-based payments (note 7)	—	—	671	—	—	671
Movement in own shares	—	—	—	(180)	(169)	(349)
Shares issued	3	1,245	—	—	(829)	419
As at 31 December 2019	1,128	160,106	13,968	(768)	9,771	184,205

For the year ended 31 December 2019

The parent company financial statements of Smart Metering Systems plc (the Company) for the year ended 31 December 2019 were authorised for issue by the Board of Directors on 17 March 2020 and the balance sheet was signed on the Board's behalf by David Thompson. Smart Metering Systems plc is a public limited company limited by shares and incorporated and domiciled in Scotland, with its registered office at 2nd Floor, 48 St. Vincent Street, Glasgow G2 5TS. The Company's ordinary shares are traded on AIM.

1 Parent company accounting policies

Basis of accounting

These financial statements were prepared in accordance with Financial Reporting Standard 102 (FRS 102). The financial statements are prepared under the historical cost convention.

The accounting policies of the parent company financial statements follow those policies which apply in preparing the consolidated financial statements for the year ended 31 December 2019. The financial statements are prepared in Sterling and are rounded to the nearest thousand Pounds (£'000).

The Company has taken advantage of the following disclosure exemptions under FRS 102:

- ▶ section 7 Statement of Cash Flows;
- ▶ section 3 Financial Statement Presentation, paragraph 3.17(d);
- ▶ section 11 Basic Financial Instruments, paragraphs 11.42, 11.44, 11.45, 11.47, 11.48(a)(iii), 11.48(a)(iv), 11.48(b) and 11.48(c);
- ▶ section 26 Share-based Payments, paragraphs 26.18(b), 26.19 to 26.21 and 26.23; and
- ▶ section 33 Related Party Disclosures, paragraph 33.7.

Disclosure of auditor remuneration for non-audit fees is not given in the individual financial statements as the Group accounts are required to comply with regulation 5(1)(b) of the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 and present the information on a consolidated basis.

The Company is a guarantor in respect of the Group's revolving credit facilities.

Going concern

Based on the current projections and facilities in place, the Directors consider it appropriate to continue to prepare the financial statements on a going concern basis.

Investments

Investments in subsidiary undertakings are stated in the balance sheet of the Company at cost, or nominal value of the shares issued as consideration where applicable, less provision for any impairment in value.

Share-based payments

The grant by the Company of options and share awards over its equity instruments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services rendered, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to the investments in subsidiary undertakings, with a corresponding credit to equity in the Company financial statements. The credit to equity is recognised within other reserves as these amounts are non-distributable at the Company level.

2 Investments

Carrying value	2019 £'000	2018 £'000
At 1 January	19,784	24,782
Share-based payments (note 7)	671	1,208
Impairment	(228)	(6,206)
At 31 December	20,227	19,784

During 2019 and 2018, a number of subsidiary companies granted options and share awards to their employees over the shares of SMS. For accounting purposes, these grants are recorded as investments by the Company in its subsidiary undertakings.

Investments in subsidiaries are assessed annually to determine if there is any indication that any of the investments might be impaired.

As part of a strategic Group-wide decision to use the previously acquired installation and IT resource internally to support the domestic smart meter rollout, the three trading entities acquired in 2016 no longer plan to trade externally to the Group over the medium term. These three subsidiaries have become cost centres to support the Group's operations and were in a net liabilities position at 31 December 2019 and 31 December 2018. Therefore, management has recognised an impairment charge, writing down the carrying value of the Company's investment in these three subsidiary undertakings to £Nil. This has resulted in an impairment charge of £228,000 (2018: £6,206,000).

2 Investments continued

Subsidiary undertakings

	Registered office	Holding	Proportion of shares held	Nature of business
SMS Connections Limited	1	Ordinary shares	100%	Gas utility connections
SMS Meter Assets Limited	1	Ordinary shares	100%	Gas and electric asset management
SMS MAPCO 1 Limited	1	Ordinary shares	100%	Gas and electric asset management
Crail Meters Limited**	1	Ordinary shares	100%	Gas and electric asset management
SMS Data Management Limited	1	Ordinary shares	100%	Data management
UKMA (AF) Limited*	2	Ordinary shares	100%	Funding
SMS Corporate Services Limited‡	1	Ordinary shares	100%	Administrative services
SMS Energy Services Limited	2	Ordinary shares	100%	Electricity utility connections and management
CH4 Gas Utility and Maintenance Services Limited*	2	Ordinary shares	100%	Meter installation
SMS Utilities Academy Limited**	2	Ordinary shares	100%	Engineer training and development
Trojan Utilities Limited*	2	Ordinary shares	100%	Meter installation
Qton Solutions Limited*	2	Ordinary shares	100%	Business and domestic software development
Solo Energy Limited (UK)**	1	Ordinary shares	100%	Renewable asset management
Solo Energy Limited (Ireland)**	3	Ordinary shares	100%	Renewable asset management

* The shareholding in this company is indirect via a subsidiary company.

‡ Newly incorporated entity in 2019.

1 Registered office address: 2nd Floor, 48 St. Vincent Street, Glasgow G2 5TS.

2 Registered office address: Prennau House, Copse Walk, Cardiff Gate Business Park, Cardiff CF23 8XH.

3 Registered office address: Phoenix House, Monahan Road, Cork T12 H1XY.

3 Debtors: amounts falling due within one year

	2019 £'000	2018 £'000
Amounts owed by Group undertakings	163,978	156,690

Amounts owed by Group undertakings are repayable on demand.

4 Creditors: amounts falling due within one year

	2019 £'000	2018 £'000
Amounts due to Group undertakings	—	627

5 Related party transactions

During the year, the Group paid dividends to Alan Foy of £281,382 (2018: £244,641), The Metis Trust¹ of £56,520 (2018: £49,140), David Thompson of £84 (2018: £27), Miriam Greenwood of £1,046 (2018: £893), Willie MacDiarmid² of £372 (2018: £323), Graeme Bissett of £333 (2018: £289) and Tim Mortlock of £121 (2018: £Nil).

1 Alan Foy is a trustee but not a beneficiary.

2 Paid to a connected person.

For the year ended 31 December 2019

6 Share capital

	2019 £'000	2018 £'000
Allotted and called up:		
112,811,122 ordinary shares of £0.01 each (2018: 112,548,050 ordinary shares of £0.01 each)	1,128	1,125

During the year 125,519 (2018: 97,250) ordinary share options were exercised in relation to the Group's employee share plans which are described in note 23. The ordinary shares issued have a nominal value of £1,000 (2018: £1,000) and aggregate consideration of £419,000 (2018: £270,000) was received.

In addition, 137,553 shares were issued during the year (2018: nil) in relation to deferred remuneration arising on the acquisition of a subsidiary in 2016, settled in shares in April 2019. The ordinary shares issued have a nominal value of £2,000 and a fair value of £829,000. No consideration was received for these shares. The total fair value of £829,000 has been recognised directly within retained earnings and the difference between the fair value and nominal value of £827,000 has been recognised within share premium.

The Group's Share Incentive Plan is administered by the Smart Metering Systems SIP Trust (the trust), which acquires shares in SMS (own shares) to satisfy awards under this plan and facilitate the delivery of shares to participants. At 31 December 2019, 146,412 (2018: 111,307) own shares were held in trust with a carry value of £768,000 (2018: £588,000) and a market value of £827,000 (2018: £584,000). The Company purchased 67,220 shares (2018: 36,137) from the market during 2019 with a weighted average fair value of £5.20 per share (2018: £6.34).

7 Other reserves

Other reserves are non-distributable and include the following items:

- ▶ a reserve that initially arose by applying merger relief under section 612 of the Companies Act 2006 to the shares issued in 2009 in connection with the Group restructuring. Additionally, the premium of £4,189,000 and £1,115,000 arising on the issue of shares as part of the acquisitions of CH4 Gas Utility and Maintenance Services Limited (CH4), Trojan Utilities Limited (Trojan) and Qton Solutions Limited (Qton) has been credited to this reserve; and
- ▶ a share-based payment reserve, arising as a result of the grant by the Company of options and share awards over its equity instruments to the employees of subsidiary undertakings in the Group.

8 Dividends

Please refer to details in note 8 of the notes to the Group financial statements.



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