

Smart Metering Systems plc
("SMS" or "the Company" or "the Group")

Final results for the year ended 31 December 2018

Smart Metering Systems plc (AIM: SMS.L) is pleased to announce its final results for the 12 months to 31 December 2018, which show continued underlying business growth.

Financial highlights

- Revenue increased by 24% to £98.5m (2017: £79.6m)
- Total annualised recurring revenue¹ increased by 32% to £75.3m (2017: £57.0m)
 - Gas: meter recurring revenue increased by 19% to £42.9m (2017: £36.1m) and data recurring revenue increased by 6% to £3.13m (2017: £2.96m)
 - Electricity: meter recurring revenue increased by 81% to £20.3m (2017: £11.2m) and data recurring revenue grew 34% to £9.0m (2017: £6.7m)
- Pre-exceptional EBITDA¹ increased by 28% to £51.6m (2017: £40.3m)
- Underlying PBT¹ increased by 13% to £25.1m (2017: £22.2m)
- Gross profit increased by 3% to £41.5m (2017: £40.4m), with gross margin decreasing by 9% to 42% (2017: 51%)
- Exceptional items of £17.1m (2017: £2.0m), reflecting the reduced carrying value of meter assets, predominantly in the Group's traditional meter portfolio
- Statutory EBITDA decreased by 9% to £35.5m (2017: £38.8m), with statutory EBITDA margin decreasing by 13% to 36% (2017: 49%)
- Statutory Profit before tax decreased by 70% to £5.4m (2017: £18.0m)
- Underlying earnings per share¹ decreased to 18.46p (2017: 19.93p) and statutory earnings per share decreased to 3.97p (2017: 16.17p)
- Final dividend proposed of 3.98p per ordinary share totalling 5.98p for the full year (2017: 5.20p), an increase of 15%
- Net debt at 31 December 2018 was £142.0m (2017: £36.5m), with access to cash and undrawn facilities at 31 December 2018 of £138.0m (2017: £243.5m), increasing to £277.0m on 3 January 2019

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

Operational highlights

- Total gas and electricity metering and data assets increased by 1.1m to 3.13 million under management at 31 December 2018 (2017: 2.03 million)
 - Total gas meter portfolio, including third-party management assets, increased by 65% to 2,106,000 (2017: 1,273,000), with industrial and commercial (I&C) meters increasing by 6% to 173,000 (2017: 163,000). Gas data portfolio increased by 4% to 131,000 (2017: 126,000)
 - Total electricity meter portfolio increased by 78% to 552,000 (2017: 309,000). Electricity data portfolio increased by 7% to 345,000 (2017: 323,000)
- ADM™ installations up 2% to 105,000 units (2017: 103,000) with international trials continuing
- Capital expenditure on revenue-generating assets was £128.2m (2017: £122.5m)
- Over 30,000 hours of engineer training delivered in 2018
- First dedicated smart metering training facility in the UK established and the facilitation of a test lab to assist with DCC SMETS2 readiness
- Employed 964 people at 31 December 2018 and reached the milestone of becoming a living wage employer
- Recognised by the Office of Low Emission Vehicles (OLEV) as an accredited installer of electric vehicle charging points for the government's Workplace Charging Scheme (WCS)

Alan Foy, Chief Executive Officer, commented:

"2018 has been a year of continued investment and growth, and I am especially pleased with the way in which we have brought our end to end solutions to the UK's energy suppliers shown by the significant contract wins announced in the last 6 months.

Building long term partnerships with our customers is key to our success. We enter 2019 with a strong order book and are well positioned to continue making progress in our core markets."

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Notes to Editors

About Smart Metering Systems

Established in 1995, Smart Metering Systems plc, headquartered in Glasgow, installs, owns, operates and maintains gas and electricity meters on behalf of major energy companies in the UK energy and utilities market.

The SMS Asset Management business delivers long term stable income from ownership of over 3.1 million utility metering assets.

The SMS Asset Installation business installs gas and electricity meter assets for the Meter Asset Management business through engineering workforce across the UK.

The SMS Energy Management business provides energy management and consultancy services to support large blue-chip companies in the UK, through a network of offices across the UK.

The energy management and asset installation services also include infrastructure design, installation, consultancy and project management services for new gas, electricity, water and telecoms connections for licensed energy and telecoms suppliers, end consumers and the UK's licensed electricity Distribution Network Owners (DNO's).

The Company was quoted on AIM in July 2011 and is now part of the FTSE AIM 50 index. For more information on SMS please visit the Company's website: www.sms-plc.com.

About DCC (Data Communications Company)

DCC is leading the design, build, test and integration of the data and communications infrastructure to connect with the business systems of energy.

Smart DCC Ltd (DCC) operates under the [Smart Meter Communication Licence](#) which was granted by the Department of Business, Energy and Industrial Strategy (BEIS) and is regulated by Ofgem.

Chairman's statement

2018 has, once again, been an excellent year for SMS, with substantial and increased capital investment in metering assets being reflected in the significant growth in annualised recurring revenues and our trading performance.

The Group, as at 31 December 2018, had more than 3.1 million metering and data assets under management, up 54% from 2.0 million at the end of 2017. We have established a substantial source of long-term, index-linked recurring revenues, in a secure and established asset class. We continue to demonstrate that we have proven operational and financial capacity and the platform to deliver the smart domestic meter rollout. As a result, we saw a 32% increase to £75.3m in annualised recurring revenues. This recurring revenue stream, which provides long-term returns, firmly underpins our robust investment proposition.

SMS is now one of the largest installers of meter assets in the UK. The domestic smart market opportunity continues to be the clear focus for us, but, as you would expect, we are also looking ahead to ensure that we have the capabilities to deliver integrated energy solutions to our customers. By investing in smart meters, we are establishing the foundations for a business at the centre of the energy system as we transition to a more sustainable and low-carbon future.

People and systems

We are now a business nearing 1,000 people across the UK and, as we continue to grow, investing in our people has never been more important. We are continuously working to ensure that we foster a culture which enables all our staff to uphold the highest levels of integrity, and to maintain a positive empowering environment in which we encourage all colleagues to take responsibility, and to make a difference to our organisation and to our customers every day.

Our business strategy is to provide a market-leading service in our industry and we continue to work towards becoming an "Employer of Choice". During 2018, we harmonised our people policies and procedures across the Group and, as we enter 2019, we have embarked on projects to enhance our current benefits package for employees. We continue to develop our business to ensure we offer a culture and environment that attracts and retains exceptional employees. I would like to thank all the staff at SMS for their commitment and contribution to our continuing success.

We have continued to invest in the business infrastructure to support this staff growth, and we are building on our experienced and proven management team, which is now focused on successfully delivering the transition from SMETS1 to SMETS2, innovation in our future services and our growth plans.

Technology, information security and IT systems are critical to the delivery of the smart meter rollout, the transition to SMETS2, the delivery of a first-class customer experience, and the development of our services beyond smart meters to deliver the future of smart energy and a low-carbon energy system. The importance of technology is reflected in our continued and substantial investment in this area to support our existing and future service offering.

Health and safety

Our primary focus is on health and safety and we have standardised policies and protocols designed to protect our employees and customers, including training, testing and risk assessments. Health and safety is always the key Group priority, with the Board ensuring appropriate engagement throughout our workforce to promote and achieve healthy and safe conditions. We have increased investment in our compliance and training resources, with executive leadership actively involved, and have implemented a new electronic safety management system and launched a new mandatory health and safety training regime. We actively encourage our employees to stop work when they feel safety may be compromised, to report all incidents or near misses however small, and to continually invest and rigorously challenge, evaluate and assess the risks within our business.

Dividend

We aim to provide a progressive, through-cycle dividend that shares the rewards of our profitability and growth with shareholders and provides a sustainable return.

The Board is pleased to announce a proposed final cash dividend of 3.98p per ordinary share for the year ended 31 December 2018 (2017: 3.46p). In addition to the interim dividend of 2.00p (2017: 1.74p), this will give a total ordinary dividend of 5.98p (2017: 5.20p), an increase of 15% on last year.

Delivering our strategy

Our strategic priorities, in 2019, are to:

1. Continue to increase our metering installation run rates in the Domestic and Industrial and Commercial (I&C) markets to further grow our 3.1 million metering and data assets currently under management.
2. Build on our strategic positioning and investment in capacity to take advantage of the domestic smart market opportunity in the UK, carefully managing the technology, logistics and engineering challenges associated with the SMETS2 delivery. This is founded on our proven end-to-end delivery capability, increasing capacity and track record of customer service and operational delivery.
3. Innovate our services to build data, energy, financing and installation capabilities that enable our customers to reduce their carbon emissions and facilitate our investment in infrastructure asset classes which provide long-term recurring revenue.

Looking beyond the smart meter rollout, we will continue to invest in our business – strategically positioning ourselves as an integrated energy solutions provider, seeking partnerships to support this.

Outlook

2018 has seen us accelerate our annualised recurring revenues and our trading performance, and significantly increase capital investment in metering assets accordingly, making us one of the largest installers of meter assets in the UK.

As we enter 2019, the domestic smart market provides us with a significant opportunity for further growth. We will continue to manage the business change required through the transition from SMETS1 to SMETS2 meters and fully expect our smart meter installation run rates to increase in the second half of 2019 as the smart meter rollout enters its main phase.

In understanding our business, it is crucial to remember that data is at the centre of everything we do. Through the installation of smart meters, we deploy the devices that produce the data essential for managing and understanding energy flows and we use this data across our range of services to help our clients make better decisions and achieve operational efficiency and sustainability. We will continue to develop our capabilities to deliver innovative and integrated energy solutions to our customers, leveraging the foundations we have established in smart meters to grow our service proposition.

Chief Executive Officer's statement

Overview

It is a privilege to report on the continued growth and success of SMS for the year ended 31 December 2018, an exciting twelve months during which we extended and deepened our relationships with our energy supplier customers. As a result, we have strengthened our position at the heart of the low-carbon, smart energy revolution, a transformation that is well underway and is pivotal in realising a greener, more sustainable world.

Our successful journey has been made possible by listening to our customers and, in partnership with them, an untiring ambition to offer solutions which deliver the future of smart energy. We do this by providing smart meter, data and energy services which give greater control over the generation, use and storage of energy. Our valued service offer prioritises safety and builds on our engineering installation experience, knowledge, finance and technology to deliver an unrivalled customer experience whilst generating sustainable and recurring revenue streams.

A significant part of our growth has been due to the continued expansion of our customer pipeline in the mandated smart domestic meter rollout. Our contracted customer pipeline, through our exclusive and framework agreements, also gives us access to a further c.2.0 million meter points.

Installation run rates dipped in the second half of 2018 as we began the industry-wide transition from SMETS1 to the second-generation SMETS2 smart meters, which we anticipated. We are now well positioned with the engineering capacity to accelerate the delivery of this pipeline as we progress into the second half of 2019.

The transition to SMETS2 has required investment in our supply chain to move from SMETS1 meter stock to the SMETS2 meters and communication hubs which will immediately connect to the Data Communications Company (DCC), the body set up by the government to collect data from all smart meters. The DCC has made significant progress, supported by our test labs in Cardiff, in progressing the enrolment and adoption of SMETS1 meters into the DCC systems, a process which will make them interoperable through an over-the-air integration programme to be rolled out during 2019.

Key highlights

We have seen substantial growth in our gas and electricity meter and data portfolio under management, which increased by 54% from 2.0 million to over 3.1 million assets. Meter assets grew by 68% from 1,582,000 to 2,658,000, and data assets grew by 6% from 449,000 to 476,000 data points.

Our success during the year has also been demonstrated in the number of contract wins we have been pleased to announce with both new and existing energy supplier customers. This includes exclusive arrangements with First Utility (Shell Energy) and Good Energy, and framework agreements with Co-op Energy, Bristol Energy and Octopus Energy. Most recently, we are delighted to have signed an agreement with SSE Energy Supply, with whom we have a longstanding relationship, which provides us with the opportunity to supply and install up to 200,000 SMETS2 non-domestic meters to its small business customers. Whilst energy suppliers have seen a number of challenges, particularly independent or “challenger” entrants, we are pleased to be partnering with robust businesses who, like SMS, are committed to the smart meter revolution.

Our primary financial KPI is our annualised long-term index-linked recurring revenue (our recurring rental revenue from our installed meter and data asset base) which increased by 32% from £57.0m to £75.3m as of the end of 2018. This increase of £18.3m compares to an increase of £15.7m in 2017, despite the decrease in installation run rates in the latter part of 2018 as we transition to SMETS2 meter stock. As at the 1 April 2019 our annualised recurring revenue had increased to c.£80m supported by further growth in our smart meter portfolio to 932,000 smart meters. This growth and the expanding order book from our contracted customers provide the context for the increase in our banking facilities.

Our annual recurring index linked revenue is at the core of our long-term cash-generative financial model. Once installed, our long-term assets provide recurring rental revenue for their lifetime and sit alongside the provision of maintenance, support and continuing service opportunities.

As the smart meter rollout enters a significant phase in 2019, we have taken the decision to write down the value of our traditional meter portfolio.

We continue our focus on ensuring our culture of customer excellence is front of mind for all our staff. Delivering on our promises of attention to detail and going the extra mile, with integrity and passion, is critical to our continued success and we will keep listening to our customers as we evolve our services within and beyond the immediate smart meter rollout.

This proven culture of success is a clear reflection of strength of the Company’s leadership and wider Executive team and provides confidence as to the continued execution of our strategy within the smart meter rollout.

Industrial and Commercial (I&C) market

In 2018, we continued to install advanced meters for the I&C market (and provide data services by collecting meter consumption information); we are now beginning to see a shift in focus to extend the smart metering rollout to the micro-business sector. We believe our proven experience of delivering quality services to I&C customers with the installation of advanced meters (and data services allied to our experience of smart) will provide the foundation of success in this significant market segment. We expect this segment to grow, particularly as I&C energy suppliers begin to focus on their mandated requirements under the smart meter programme which apply to the micro-business segment as to the Domestic market.

We continue to deploy the ADM™ device in the I&C gas market. This is our advanced metering solution which provides half-hourly meter read information and we have invested further to provide 3G/4G/5G capability which we believe will support its potential for deployment as part of other UK and international utility metering solutions.

UK Domestic market

Over the year, we significantly extended our portfolio of smart meters as part of the UK government’s mandated smart meter programme, which requires all UK households and small businesses to be offered a smart meter by the end of 2020. However we anticipate the domestic smart meter exchange to extend to the end of 2022, and potentially into 2023. We now own 846,000 smart domestic meters (+100%), with substantial contracted pipeline opportunities from both our exclusive and framework energy supplier customers.

There are c.53 million gas and electricity meters in the UK and, as of the end of December 2018, there were 14.9 million smart and advanced meters installed in homes and businesses across the country. The market share of “challenger” energy suppliers in the Domestic market has increased to c.25% at the start of 2019 (c.13 million meters). SMS now has either framework or exclusive agreements with twelve of the independent energy suppliers, equivalent to a potential 8 million meter points. We continue to engage with all energy suppliers in the market with the ability to offer both financial and operational capacity to provide certainty to deliver their mandated obligations.

Evolution

The execution of the delivery phase of the smart domestic rollout is without doubt a major growth opportunity for us, with even greater opportunity beyond that from the changing energy market enabled and facilitated by the smart energy revolution. We are optimistic about the future energy market opportunities which our business model presents and we are confident that we can effectively leverage our existing capabilities in its delivery.

With the increasing demand for our utility connections and energy management services, we are investing to diversify and innovate in energy, installation and data services which will support the transition and decarbonisation of the UK energy system.

We are proud to have been recognised by the Office of Low Emission Vehicles (OLEV) as an accredited installer of electric vehicle charging points for the government’s Workplace Charging Scheme (WCS). Through the WCS, UK business can benefit from a grant towards the cost of installation of electric vehicle charging points, and as an accredited OLEV installer, funder and expert energy consultant we are not only able to design and deliver the installation, but also to maximise value through provision of integrated energy strategies.

We are also pleased to have delivered a major LED lighting retrofit project for a major national hotel chain during 2018 and are continuing to identify and deliver opportunities to invest and deliver energy efficiency reduction strategies and to optimise building control solutions which, allied to our leading data presentation and analytics systems, provide smart monitoring and energy reduction solutions across the country.

We are trialling the installation of innovative battery storage and generation solutions, typically upstream of the customer meter. Working closely with both our I&C corporate customers and energy supplier partners, we are currently developing services which aggregate such opportunities to maximise returns by shifting demand and aligning generation/export with demand.

Whilst still at a trial stage, we believe that these developments, in combination with our accredited provision of half-hourly settlement services to energy suppliers (enabling the purchase/trading and settlement of energy use on a half-hourly basis through smart meter consumption data) and continued technology investments provide significant market opportunity for further capital deployment and recurring revenue streams beyond smart metering. These opportunities will also leverage on our highly trained national engineering workforce and smart home installation capabilities developed initially for the smart meter rollout.

It goes without saying that our people remain our most valuable asset, and we continue to invest in training, development and balanced benefits packages, as well as strategically investing ahead of time in the future of our business. I would like to thank all our employees for their continued hard work, dedication and commitment in delivering for our customers and the ongoing success of our business.

As a major energy services and smart metering company, which places data and sustainability at the core of our ethos and business model, we are excited to be at the heart of the revolution in the United Kingdom with a mission to deliver the future of smart energy.

Financial review

Financial results

The Group has delivered a strong underlying performance for the year, with reported revenue increasing by 24% to £98.5m and pre-exceptional EBITDA increasing by 28% to £51.6m. We have again seen a record year of growth in our revenue-generating assets, having invested £128.2m, and have grown our smart meter portfolio by 100%, or 423,000 meters, in this year alone. Underlying profit before taxation has increased by 13% to £25.1m. Whilst the Group has clearly grown its base of annualised recurring rental assets, there continues to be a requirement for tactical investment in our smart meter installation capacity that underpins our end-to-end service offering. The depreciation charge, largely driven by investment in our meter portfolio, and our largest non-cash cost item, has grown from £14.1m to £21.8m. This investment in meter capacity, infrastructure and the associated depreciation charge resulted in slower growth at the PBT level. We therefore use annualised recurring revenue (ARR), revenue and pre-exceptional EBITDA as the key performance measures of the business. On a statutory basis, after charging £17.1m of exceptional costs, the profit before tax was £5.4m (2017: £18.0m).

Divisional trading performance

Asset Management revenue grew 35% to £65.5m (2017: £48.7m) largely due to the continued transition into the Domestic smart market with our domestic smart meter portfolio doubling during the year to 846,000. Energy Management revenue has increased by 89% to £6.5m (2017: £3.4m), primarily attributable to the commencement of a nationwide energy-efficient lighting project for a large hotel chain. Asset Installation revenue has decreased 3.5% to £26.6m (2017: £27.5m) due to legacy installation-only contract work from the acquisition of Trojan Utilities Limited diminishing, and a decreasing portfolio of domestic traditional meters requiring transactional works. The continuation of legacy installation-only type works is being phased out as part of a wider strategic decision to allocate our internal engineering resource to fit our own portfolio of smart meters.

Overall, the depreciation-adjusted gross profit margin at a Group level has decreased by 5% to 63% (2017: 68%). We include depreciation on our revenue-generating assets within cost of sales and removing this from our margin analysis provides a better comparison of underlying trading performance year on year. Our strategic decision to invest in the smart meter rollout and more infrastructure-type projects means sales activity will grow, albeit at a lower margin caused by this changing mix. The key drivers behind this margin trend are the focus away from external meter installation activity in our Asset Installation division and the increase in infrastructure-type projects undertaken within our Energy Management division which generate increased revenue, albeit at a lower overall margin.

To support the significant growth in the business we have continued to invest in our people across all areas, from our engineering workforce, to the operational support department and our central functions. Development of our people is critical to the growth of the business and our investment in our employees and their skill set will continue. As an example of this continued investment, in the final quarter of 2018 we opened an additional customer experience centre in Bolton to facilitate the conversion of the UK to domestic smart meters. This new facility will employ over 150 people and aims to be a best in class operational hub to drive the business through the smart meter rollout.

Other costs in the year which impacted our underlying profitability include a £1.1m bad debt write off in relation to smaller independent energy suppliers that have ceased trading. As a consequence our credit risk has improved going forward because these end consumers were transferred to much larger energy suppliers under the "Supplier of last resort mechanism". Further, we made investment of £0.5m in the training of smart engineers in the year.

Annualised recurring revenue

Total annualised recurring revenue increased by 32% to £75.3m as at 31 December 2018. In the gas division, meter recurring revenue grew by 19% to £42.9m, while data recurring revenue increased 6% to £3.1m. In the electricity division, meter recurring revenue nearly doubled to £20.3m and data recurring revenue grew 34% to £9.0m.

This growth continues to be predominantly driven by the domestic smart meter rollout with the installation of dual fuel meters favouring higher growth in our younger electricity portfolio, when compared with our historic gas-weighted portfolio.

Investment in revenue-generating assets

With the domestic smart meter rollout progressing, we have seen our portfolio of revenue-generating assets, including the meter assets and their associated data points, grow 54% to 3.1 million as at the end of 2018. Whilst we have seen our installation rates slow in the latter part of 2018 and into early 2019 as we approach the SMETS1/2 crossover, we are confident that these will recover in the first half of 2019 as the DCC becomes operational in scale. Based on the contract wins in the second half of the year, we are holding our cost base in respect of engineers and infrastructure support during this transitional period to ensure we are best placed to accelerate our run rates into 2019. We continue to win significant contracts, as evidenced by our first "big six" win in smart metering with SSE Energy Supply on 18 March 2019, and will, therefore, continue to build our installation capacity, grow and develop our pool of in-house engineers, and manage our stock to ensure we can meet the demands facing us through 2019 and beyond.

	31 December 2018 units	31 December 2017 units	Percentage increase
Gas meter portfolio*	2,106,000	1,273,000	65%
Electricity meter portfolio	552,000	309,000	78%
Gas data portfolio	131,000	126,000	4%
Electricity data portfolio	345,000	323,000	7%
Total meter portfolio*	2,658,000	1,582,000	68%
Total data portfolio	476,000	449,000	6%
Total gas and electricity metering and data assets	3,134,000	2,031,000	54%

* Includes third-party meter management appointments.

Exceptional items

The charge to the income statement in respect of exceptional items of £17.1m is largely caused by the recognition of £12.6m of losses on our meter portfolio (including an impairment charge of £5.6m) due to the temporary industry transition period. We show these meter removals and the associated termination income as an exceptional item as the removal profile is outside our control and there is inherent volatility in the associated financial impact.

The largest reduction in carrying value relates to the traditional meter portfolio. We had reduced the expected useful life of this asset class from 20 to 5 years when the smart meter rollout began, in earnest, in 2016. This decision was taken to reflect the accelerated removal of these traditional meters when exchanged for a smart meter, well in advance of their actual useful life. Important judgements surround this removal profile and the associated termination income received, as the timing of the removal of these meters is entirely outside our control with removal dependent on when the end consumer switches to a smart meter. Termination income can also vary depending on the identity of the energy supplier at the time of removal. During the year the estimated life was extended to 2022. We regularly review the traditional meter portfolio for impairment by comparing a calculated "value in use" against the carrying value on our balance sheet. Due to an increase in removals in 2018, particularly in H2, our impairment review has resulted in the write down of this carrying value by £5.6m to reflect the reduction in rental income going forward from the reducing portfolio of these meters remaining on the wall. To assist the users of our financial statements, we will also disclose separately the constituent parts of these accounting adjustments so that the traditional meter portfolio can be better tracked. Further, as we do not consider the entirely variable and unpredictable financial result of the decline of the traditional meter portfolio to represent the underlying nature of our business, we do not include these items in our underlying measures of performance. Additional information on the results from the traditional estate is provided in note 10 to the financial statements.

We have also seen a net balance of £3.0m written off against the carrying value of our smart portfolio in 2018. This represents approximately 12,500 meters, or 1.5% of our portfolio as at 31 December 2018, which were removed in the year by new energy suppliers on customer churn and replaced by similar SMETS1 meters albeit from a different manufacturer. The main driver of these replacements we believe to be the small minority of cases of churn when 2-way communication is temporarily lost due to the SMETS1 meter not yet having been adopted into the DCC. With the enrolment and adoption process of SMETS1 meters into DCC having now begun, we do not expect this type of meter removal to continue beyond 2019. We have treated the loss of these meters as exceptional due to this temporary industry transition period.

Further, we have taken the decision to write down the value of returned and refurbished traditional meters held in inventory pursuant to an internal review. This year-end decision was supported by the release on 22 January 2019 of a consultation from the department of Business, Energy & Industrial Strategy (BEIS) to introduce a "New or Replacement Obligation" to help drive the switch to smart meters. This proposal, planned to become effective in H1 2019, will further reduce the opportunity to redeploy domestic traditional meters on a short-term basis. We see this as a positive step for our business, requiring less resource to handle and refurbish these assets and allowing us to focus more resource on smart meter exchanges. A one-off charge of £1.6m has been recognised in 2018 in relation to this write down. Consistent with our approach, we treat write-offs of inventory value relating to traditional meters as exceptional charges.

Other exceptional items include bank and professional fees relating to the arrangement of our new banking facility (£1.0m), payments relating to deferred remuneration arising from the acquisition of a subsidiary in 2016 (£0.7m) and costs associated with the settlement of a legacy Employee Benefit Trust (£0.8m).

Financial resources

With further growth anticipated as the UK domestic smart meter rollout continues, we reviewed our longer-term funding during 2018 and decided upon a flexible strategy to allow us the capability to match the pace of the smart rollout. 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 therefore removing any amortisation in that period. The first drawdown under this new facility was on 3 January 2019, and at that date the Group's obligations under the existing facility were settled. The support from our new banking syndicate comprising Barclays Bank plc, Santander UK plc, HSBC UK, Clydesdale Bank plc, Bank of Scotland plc and BNP Paribas is invaluable, providing us with significant additional financial capacity.

We ended the year with a net debt position of £142.0m (2017: £36.5m), with the increase in our continued investment in the domestic smart meter estate. The Group's pre-exceptional Net Debt/EBITDA ratio remains well within covenant at around 2.75x (2017: 0.9x) and as at 31 December 2018 the Group's available cash and unutilised element of the revolving credit facility stood at £138.0m (2017: £243.5m), increasing to c.£277.0m after the first drawdown under the new facility on 3 January 2019.

Dividends

SMS has a progressive ordinary dividend policy, and our objective is that ordinary dividends will steadily increase on an annual basis.

The Board considers the dividend in the context of the overall funding of the business, taking into account obligations under our existing facility arrangements and our strategy of further capital deployment to ensure we can meet the demands of the UK smart meter rollout. We aim to apply a balanced approach, using profits and cash flow to pay shareholder dividends whilst retaining sufficient capital to fund investment in meter assets.

The Board has declared a final ordinary dividend for the year of 3.98p (2017: 3.46p) per share. This results in a total ordinary dividend for the year of 5.98p (2017: 5.20p), an increase of 15% on last year. The final ordinary dividend payment will be paid in early June 2019 to shareholders on the register on 26 April 2019.

We remain confident that SMS is able to support a growing dividend for the foreseeable future, whilst continuing to invest in the business.

Outlook

We are very pleased with our results for 2018, which have shown increased revenues and profitability and a continued growth in our capital investment in revenue-generating assets.

Having successfully secured access to funding of up to £420m over the next five years, we are in a strong position to effectively manage our meter portfolio in order to meet upcoming deployment demand in H1 2019 as the crossover to SMETS2 takes effect.

In this way we are confident that we can continue to retain momentum through the rollout and maximise the opportunity to obtain additional market share of the meter portfolio in the UK.

Alternative performance measures

The Group uses alternative performance measures, as listed below, to present users of the accounts with a clear view of what the Group considers to be the results of its underlying, sustainable business operations, thereby enabling consistent period-on-period comparisons and making it easier for users of the accounts to identify trends.

Alternative performance measure	Definition
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.
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.
Adjusted basic EPS	Underlying profit after taxation divided by the weighted average number of ordinary shares for the purposes of basic EPS.
Adjusted diluted EPS	Underlying profit after taxation divided by the weighted average number of ordinary shares for the purposes of diluted EPS.

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.

A reconciliation of these alternative performance measures has been disclosed in the table below:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m	Percentage increase
Group revenue	98.5	79.6	24%
Annualised recurring revenue	75.3	57.0	32%
Statutory profit from operations	11.1	22.6	
Amortisation of intangibles	2.6	2.2	
Depreciation	21.8	14.0	
Statutory EBITDA	35.5	38.8	(9%)
Exceptional items (EBITDA related)	16.1	1.5	
Pre-exceptional EBITDA	51.6	40.3	28%
Net interest (excl. exceptional)	(4.7)	(4.1)	
Depreciation	(21.8)	(14.0)	
Underlying profit before taxation	25.1	22.2	13%
Exceptional items (EBITDA)	(16.1)	(1.5)	
Exceptional items (interest)	(1.0)	(0.5)	
Amortisation of intangibles	(2.6)	(2.2)	
Statutory profit before taxation	5.4	18.0	(70%)
Taxation	(0.9)	(3.3)	
Statutory profit after taxation	4.5	14.7	
Amortisation of intangibles	2.6	2.2	
Exceptional items (EBITDA and interest)	17.1	2.0	
Tax effect of adjustments	(3.4)	(0.8)	
Underlying profit after taxation	20.8	18.1	
Weighted average number of ordinary shares (basic)	112,408,338	90,655,868	
Adjusted basic EPS (pence)	18.46	19.93	
Weighted average number of ordinary shares (diluted)	113,465,235	91,783,618	
Adjusted diluted EPS (pence)	18.29	19.69	

Consolidated income statement and statement of comprehensive income

For the year ended 31 December 2018

	Notes	2018 Before exceptional items £'000	2018 Exceptional items £'000	2018 Total £'000	2017 Before exceptional items £'000	2017 Exceptional items £'000	2017 Total £'000
Revenue	2, 28	98,492	—	98,492	79,593	—	79,593
Cost of sales	3, 28	(51,333)	(5,612)	(56,945)	(39,164)	—	(39,164)
Gross profit		47,159	(5,612)	41,547	40,429	—	40,429
Administrative expenses	3	(21,263)	(10,529)	(31,792)	(19,755)	(1,515)	(21,270)
Other operating income	3	1,330	—	1,330	3,446	—	3,446
Profit from operations	3	27,226	(16,141)	11,085	24,120	(1,515)	22,605
Finance costs	5	(4,962)	(996)	(5,958)	(4,137)	(524)	(4,661)
Finance income	5	224	—	224	21	—	21
Profit before taxation		22,488	(17,137)	5,351	20,004	(2,039)	17,965
Taxation	6	(3,835)	2,948	(887)	(3,673)	367	(3,306)
Profit for the year and total comprehensive income attributable to owners of the parent		18,653	(14,189)	4,464	16,331	(1,672)	14,659

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

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

	Notes	2018	2017
Basic earnings per share (pence)	7	3.97	16.17
Diluted earnings per share (pence) (2017 restated)	7	3.93	15.97

Consolidated statement of financial position

As at 31 December 2018

	Notes	2018 £'000	2017 £'000
Assets			
Non-current assets			
Intangible assets	9	17,138	13,870
Property, plant and equipment	10	356,732	265,346
Investments	11	75	118
Trade and other receivables	14	402	594
Total non-current assets		374,347	279,928
Current assets			
Inventories	13	11,261	16,575
Other assets	17	3,105	—
Trade and other receivables	14	30,640	25,282
Income tax recoverable		292	426
Cash and cash equivalents	15	30,027	150,600
Total current assets		75,325	192,883
Total assets		449,672	472,811
Liabilities			
Current liabilities			
Trade and other payables	16	36,348	48,182
Other liabilities	17	3,105	—
Bank loans and overdrafts	17	172,016	23,197
Total current liabilities		211,469	71,379
Non-current liabilities			
Bank loans	17	—	163,887
Deferred tax liabilities	19	12,070	9,924
Total non-current liabilities		12,070	173,811
Total liabilities		223,539	245,190
Net assets		226,133	227,621
Equity			
Share capital	21	1,125	1,124
Share premium		158,861	158,592
Other reserve	23	9,562	9,562
Own share reserve	22	(588)	(697)
Retained earnings		57,173	59,040
Total equity attributable to owners of the parent		226,133	227,621

Company registration number
SC367563

Consolidated statement of changes in equity

For the year ended 31 December 2018

Attributable to the owners of the parent company:	Share capital £'000	Share premium £'000	Other reserve £'000	Own share reserve £'000	Retained earnings £'000	Total £'000
As at 1 January 2017	892	10,861	8,447	(327)	46,543	66,416
Total comprehensive income for the year	—	—	—	—	14,659	14,659
Transactions with owners in their capacity as owners						
Dividends (note 8)	—	—	—	—	(4,028)	(4,028)
Shares issued (note 21)	232	147,731	1,115	—	—	149,078
Movement in own shares (note 21)	—	—	—	(370)	70	(300)
Share-based payments (note 22)	—	—	—	—	446	446
Income tax effect of share options	—	—	—	—	1,350	1,350
As at 31 December 2017	1,124	158,592	9,562	(697)	59,040	227,621
Adjustment on initial application of IFRS 9	—	—	—	—	(49)	(49)
Restated 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 21)	1	269	—	—	—	270
Movement in own shares (note 21)	—	—	—	109	(339)	(230)
Share-based payments (note 22)	—	—	—	—	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

See notes 22 and 23 for details of the own share reserve and other reserve. The movement in share premium in 2017 is net of £4.0m of permissible costs in relation to the equity placing which took place in November 2017.

Consolidated statement of cash flows

For the year ended 31 December 2018

	2018 £'000	2017 £'000
Operating activities		
Profit before taxation	5,351	17,965
Finance costs	4,962	4,661
Finance income	(224)	(21)
Exceptional items ¹	15,426	—
Depreciation	21,796	14,061
Amortisation of intangibles	2,597	2,151
Share-based payment expense	488	446
Loss on disposal of property, plant and equipment	1,659	—
Movement in inventories	4,432	(10,454)
Movement in trade and other receivables	(5,215)	(9,300)
Movement in trade and other payables	(11,639)	22,031
Cash generated from operations	39,633	41,540
Income tax received/(paid)	408	(1,008)
Net cash generated from operations	40,041	40,532
Investing activities		
Payments to acquire property, plant and equipment	(132,643)	(123,864)
Proceeds on disposal of property, plant and equipment	4,264	3,335
Payments to acquire intangible assets	(5,887)	(1,416)
Finance income received	224	21
Net cash used in investing activities	(134,042)	(121,924)
Financing activities		
New borrowings	101,627	104,075
Borrowings repaid	(117,281)	(19,167)
Hire purchase repayments	—	(29)
Finance costs paid	(4,815)	(4,521)
Net proceeds from share issue	270	147,963
Purchase of own shares	(230)	(300)
Dividends paid	(6,143)	(4,028)
Net cash (used in)/generated from financing activities	(26,572)	223,993
Net (decrease)/increase in cash and cash equivalents	(120,573)	142,601
Cash and cash equivalents at the beginning of the financial year	150,600	7,999
Cash and cash equivalents at the end of the financial year (note 15)	30,027	150,600

¹ Non-cash exceptional items include £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.

Accounting policies

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 2018 were approved and authorised for issue in accordance with a resolution of the Directors on 4 April 2019. 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 (£) and all values are rounded to the nearest thousand (£'000) except where otherwise indicated.

The financial information set out above does not constitute the Company's statutory accounts for the years ended 31 December 2018 or 2017 but is derived from those accounts. Statutory accounts for the year ended 31 December 2017 have been delivered to the Registrar of companies and those for 2018 will be delivered in due course. The auditor has reported on both sets of accounts; its reports were unqualified, did not contain an emphasis of matter reference and did not contain statements under section 498 (2) or (3) of the Companies Act 2006.

Going concern

Management prepares budgets and forecasts on a rolling 24-month 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 existing £280m facility of £172m were settled.

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.

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.

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.

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 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 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. Management has made the judgement that amounts arising in relation to the loss of smart meter assets, attributable to this temporary industry transition period, will also be recognised 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:

- impairment of goodwill:
 - management reviews the valuation of goodwill for impairment annually or if events and changes in circumstances indicate that the carrying value may not be recoverable. The recoverable amount is determined based on value in use as fair value less costs to sell is not easily validated as there is no active market in these assets. See further details in note 12; and
- 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, giving rise to an inherent volatility to the value of these assets on our balance sheet; 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 continued to be removed from the wall.

In 2018, this assessment has given rise to an impairment charge of £5.6m on our traditional meter asset portfolio, which has been recognised as an exceptional cost of sales in line with our accounting policy (refer to details in note 10).

Revenue recognition

With effect from 1 January 2018

Refer to details in note 2.

Up to 31 December 2017

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, excluding discounts and VAT. Revenue is recognised when the significant rewards and risk of ownership have been passed to the buyer. The risk and rewards of ownership transfer when the Group fulfils its contractual obligations to customers by supplying services.

Meter rental income

Rental income represents operating lease payments receivable from gas and electricity suppliers. Revenue is recognised on a straight line basis over the lease term. Rental income is calculated on a daily basis and invoiced monthly. Rental contracts do not operate on a fixed-term basis and are cancellable at any time by the lessee, in which case termination payments are levied and recognised as other operating income in accordance with the terms of the contract with immediate effect and do not transfer risks and rewards of ownership of the underlying asset. They are therefore considered as operating lease arrangements and accounted for as such. 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.

Utility connection

Revenue from connection contracts is recognised upon delivery of the related service. Data management income is recognised on a straight line basis over the contract period. Amounts invoiced in advance are recorded as deferred income.

Energy management

Energy advice is provided and revenue is recognised when risk and reward transfers. Advice is normally quite specific so recognised on a transactional basis.

Exceptional items and separately disclosed items

The Group presents as exceptional items on the face of the consolidated statement of comprehensive income those material 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 separately as "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. Any such gain or loss on disposal relating to traditional 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

From 1 January 2018, 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

Regular way purchases and sales of financial assets are recognised on trade date (that is, the date on which the Group commits to purchase or sell the asset). 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, which include operating lease 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

From 1 January 2018, 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 and operating leases, 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 de-recognised, where there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery includes, 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 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. 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.

Accounting policies applied until 31 December 2017

The Group has applied IFRS 7 using the modified retrospective approach and has therefore not restated comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the Group's previous accounting policy.

Classification

Until 31 December 2017, the Group classified its financial assets in the following categories:

- financial assets at FVPL;
- loans and receivables;
- held-to-maturity investments; and
- available-for-sale financial assets.

At 31 December 2017, the Group held loans and receivables and held-to-maturity investments.

The classification depended on the purpose for which the investments were acquired. Management determined the classification of its investments at initial recognition.

Subsequent measurement

The measurement at initial recognition did not change on adoption of IFRS 9. After the initial recognition, loans and receivables and held-to-maturity investments were carried at amortised cost using the effective interest method. Financial assets at FVPL and available-for-sale financial assets were held at fair value.

Impairment

In the prior year, the impairment of trade receivables was assessed based on the incurred loss model. Individual receivables which were known to be uncollectable were written off by reducing the carrying amount directly. The other receivables were assessed collectively to determine whether there was objective evidence that an impairment had been incurred but not yet been identified. For these receivables the estimated impairment losses were recognised in a separate provision for impairment.

Receivables for which an impairment provision was recognised were written off against the provision where there was no expectation of recovering additional cash. Impairment was recognised within administrative expenses.

Financial liabilities

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

Upon adoption of IFRS 9 from 1 January 2018, there has been no change in the accounting policies previously applied.

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 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 product or system is available for use, so as to write off the cost of an asset, less its estimated residual value, over the useful economic life of that asset as follows:

- Amortisation 10% and 33% on cost straight line

Intangible assets

Intangible assets acquired separately from third parties are recognised as assets and measured at cost.

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 acquired as part of a business combination are recognised outside goodwill if the asset is separable or arises from contractual or other legal rights.

Intangible assets are amortised over their useful lives as follows:

- Software 20% and 33% on cost straight line
- Development costs 10% and 33% on cost straight line
- Customer contracts 10% on cost straight line

Useful lives are examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

Longer life software is related to underlying meter assets.

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 rental 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 20% to 31 December 2022 |
| • Plant and machinery | 33% on cost |
| • Fixtures, fittings and equipment | 15%, 20% and 33% on cost |
| • Motor vehicles | 25% on cost |

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 regards 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 has seen the estimate of residual value reduce to 0% to reflect revised customer terms in new customer contracts. As a result the income statement has been 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.

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

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.

As of 1 January 2019, SMS will change its accounting policy to account for leases under IFRS 16 Leases. The impact of this transition is discussed in the "Standards and interpretations" section below.

Group as lessor

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

These new accounting standards and amendments are applicable to the Group for the first time in 2018. IFRS 9 is further discussed in note 18 and IFRS 15 is further discussed in note 2. Also refer to note 28. None of these have had a material effect on the financial statements of the Group. These are:

Standard or interpretation		Effective date
IFRS 9	Financial Instruments	1 January 2018
IFRS 15	Revenue from Contracts with Customers	1 January 2018
IFRS 2	Classifications and Measurement of Share-based Payment Transactions – Amendments to IFRS 2	1 January 2018
Various	Annual Improvements to IFRSs – 2014–2016 cycle	1 January 2018

The standards and interpretations below will be adopted in accordance with their effective dates, to the extent that they are applicable to the Group and have not been adopted in these financial statements.

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
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 standards with a future effective date, management is reviewing the impact on the Group's financial statements. The key considerations are as follows:

IFRS 16

IFRS 16 Leases was issued in January 2016 and will have an impact from 1 January 2019 on the Group's consolidated financial statements, as all leases will be recognised on the Consolidated Balance Sheet (except for short-term and low value leases). The Group will transition to IFRS 16 using the modified retrospective application approach with no restatement of prior year comparatives.

Group as lessor

The Group acts as a lessor in its arrangements to provide meter assets to energy suppliers. Under IAS 17 the Group classified these leases as operating leases as it did not transfer substantially all the risks and rewards of ownership of the meter assets. The related meter income was recognised in line with the meter rental income policy. Upon implementation of IFRS 16, we do not expect there to be any change in the Group's accounting policies, or measurement and recognition, as it has been determined that our meter rental contracts continue to include a lease component under the definitions in IFRS 16. These arrangements will continue to be classified as operating leases with meter income recognised in line with the meter rental income policy.

Group as a lessee

The Group previously accounted for leases under IAS 17. Leases were 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 were 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 was recorded in the balance sheet as a finance lease obligation. The lease payments were apportioned between finance charges to the income statement and a reduction of the lease obligations. Rental payments under operating leases were charged to the income statement on a straight line basis over the applicable lease periods. The total cost of an operating lease was spread over the term of the lease on a straight line basis.

IFRS 16 requires lessees to recognise all leases on the balance sheet with limited exemptions for short-term leases (leases with an expected term of less than twelve months) and low value leases (where the value of the asset in the lease on inception is less than c. US \$5,000). This will result in the recognition of a right-of-use asset and corresponding liability on the balance sheet for each lease, with the associated depreciation and interest expense being recorded in the income statement over the lease period. The right-of-use asset is assessed for impairment under IAS 36 at the date of initial application.

The Group has completed its impact assessment of this standard. This impact assessment reviewed the operating leases held by the Group, which primarily consist of leases for premises, vans and office equipment, as no finance leases were in place in the year to 31 December 2018.

The Group plans to make the following policy choices upon transition to IFRS on 1 January 2019:

- The Group plans to apply IFRS 16 initially on 1 January 2019 using a modified retrospective approach. The cumulative effect of adopting IFRS 16 will be recognised through opening retained earnings with no restatement of comparatives.
- Where the Group has concluded that a contract does not contain a lease under IAS 17 and IFRIC 4 then this assumption has not been revisited on the initial application of IFRS 16.
- The value of the right-of-use asset recognised on the initial application of IFRS 16 is equal to the lease liability, adjusted for accruals and prepayments. In addition, the Group plans to apply the practical expedient that permits the exclusion of initial direct costs from the measurement of the right-of-use asset at the date of initial application.
- Services will be separated from the lease components of a contract and accounted for as an administrative expense; and
- The Group does not plan to apply IFRS 16 to its intangible assets. All leases of intangible assets recognised under IAS 38 at 1 January 2019 will continue to be accounted for as such.

The Group plans to make use of the following practical expedients available under IFRS 16:

- Leases previously classed as operating leases under IAS 17 which have a duration of less than twelve months remaining at 1 January 2019 will continue to be treated as operating leases (as set out under IAS 17) until the end of the lease prior to 31 December 2019.
- Leases previously classed as operating leases under IAS 17 for which the underlying assets meet the definition of "low value" will continue to be treated as operating leases.

The lease liability at 1 January 2019 has been measured at the present value of unpaid lease payments at this date, comprising fixed and variable lease payments. In calculating the net present value of the lease liability at 1 January 2019, the Group has determined an appropriate incremental borrowing rate for each lease based on the rate of interest that the Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset.

Based on this impact assessment, we have estimated the effect of applying IFRS 16 in its first full year of application to 31 December 2019 as follows:

- There will be recognition of a right-of-use asset and lease liability of c. £4.2m (on a pre-tax basis) at 1 January 2019 with no material impact on net assets.
- There will be no material impact on the total annual income statement charge or EBITDA in 2019 but a portion of expense previously recognised within administrative expenses will be recognised as a finance cost under IFRS 16.
- The total income statement charge over the life of the leases will remain unchanged. The impact of IFRS 16 is to recognise higher costs during the earlier stages in the lease with a reduction in costs in the later stages of the lease.

Notes to the financial statements

For the year ended 31 December 2018

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.
- Energy Management, which comprises the provision of energy consultancy services.

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 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

	Asset Management £'000	Asset Installation £'000	Energy Management £'000	Unallocated £'000	Total Operations £'000
31 December 2017					
Segment revenue	48,655	41,792	3,421	—	93,868
Inter-segment revenue	—	(14,275)	—	—	(14,275)
Revenue from external customers	48,655	27,517	3,421	—	79,593
Cost of sales	(18,958)	(17,970)	(2,236)	—	(39,164)
Segment gross profit	29,697	9,547	1,185	—	40,429
Other operating costs/income	—	—	—	(13,465)	(13,465)
Depreciation	—	(24)	—	(669)	(693)
Amortisation of intangibles	(2,151)	—	—	—	(2,151)
Exceptional items	—	—	—	(1,515)	(1,515)
Profit from operations	27,546	9,523	1,185	(15,649)	22,605
Net finance costs: exceptional	—	—	—	(524)	(524)
Net finance costs: other	(4,116)	—	—	—	(4,116)
Profit before tax	23,430	9,523	1,185	(16,173)	17,965
Tax expense	—	—	—	—	(3,306)
Profit for year					14,659

Inter-segment revenue relates to installation services provided by the Asset Installation segment to the Asset Management segment.

Depreciation of £20.4m (2017: £13.3m) associated with meter assets has been reported within cost of sales 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:

	2018 £'000	2017 £'000
Customer 1 – Asset Management	6,024	10,175
Customer 1 – Asset Installation	1,753	3,541
	7,777	13,716

Segment assets and liabilities

31 December 2018	Asset Management £'000	Asset Installation £'000	Energy Management £'000	Unallocated £'000	Total Operations £'000
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

31 December 2017	Asset Management £'000	Asset Installation £'000	Energy Management £'000	Unallocated £'000	Total Operations £'000
Assets reported by segment					
Intangible assets	10,373	3,497	—	—	13,870
Property, plant and equipment	261,992	251	—	3,103	265,346
Inventories	16,056	410	109	—	16,575
Contract assets	—	—	211	—	211
	288,421	4,158	320	3,103	296,002
Assets not by segment					176,809
Total assets					472,811
Liabilities by segment					
Contract liabilities	1,072	2,469	83	—	3,624
Bank loans	187,084	—	—	—	187,084
	188,156	2,469	83	—	190,708
Liabilities not by segment					54,482
Total liabilities					245,190

Assets not by segment include cash and cash equivalents, trade and other receivables, other assets and investments.

Liabilities not by segment include 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					
2018	134,882	2,685	—	963	138,530
2017	123,942	256	—	1,082	125,280

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 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

Year ended 31 December 2017	Asset Management £'000	Asset Installation £'000	Energy Management £'000	Total Operations £'000
Major service lines				
Metering ¹	41,039	—	—	41,039
Data Management	7,616	—	—	7,616
Utility Connections	—	11,038	—	11,038
Transactional Meter Works	—	15,688	—	15,688
Energy Management	—	791	3,421	4,212
	48,655	27,517	3,421	79,593
Timing of revenue recognition				
Services transferred at a point in time	—	14,853	—	14,853
Services transferred over time	48,655	12,664	3,421	64,740
	48,655	27,517	3,421	79,593

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.

2 (b) Assets and liabilities related to contracts with customers

The Group has recognised the following assets and liabilities related to contracts with customers:

	2018 £'000	2017 £'000
Current contract assets	22	211
Total contract assets	22	211
Current contract liabilities	3,229	3,624
Total contract liabilities	3,229	3,624

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:

	2018 £'000
Revenue recognised that was included in the contract liability balance at the beginning of the period	3,139

No revenue was recognised in 2018 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 monthly 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. 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.

In most circumstances, if a rental contract is cancelled termination payments are 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 inflation 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 inflation 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.

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 good 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.

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.

	2018 £'000	2017 £'000
Profit from operations is stated after (charging)/crediting:		
Cost of sales:		
Direct subcontractor costs	(6,786)	(4,667)
Depreciation of meter assets	(20,390)	(13,369)
Direct staff and other costs	(22,335)	(19,768)
Inventory costs	(1,822)	(1,360)
Total cost of sales (before exceptional items)	(51,333)	(39,164)
Administrative expenses:		
Staff costs	(11,447)	(12,921)
Depreciation:		
– owned assets	(1,406)	(675)
– leased assets	—	(17)
Amortisation of intangibles	(2,597)	(2,151)
Auditor's remuneration (note 3a)	(191)	(261)
(Loss)/Gain on disposal	(1,659)	970
Operating lease rentals	(2,041)	(1,621)
Research and Development costs	(307)	—
Other operating charges	(1,615)	(3,079)
Total administrative expenses (before exceptional items)	(21,263)	(19,755)
Exceptional items (note 3b)	(16,141)	(1,515)
Other operating income (note 3c)	1,330	3,446
Total operating costs	(87,407)	(56,988)

3 (a) Auditor's remuneration

Auditor's remuneration can be analysed as:

	2018 £'000	2017 £'000
Audit of the parent company and consolidated financial statements	55	69
Audit of the financial statements of the Company's subsidiaries	107	133
Other services – audit related assurance services	29	59
	191	261

3 (b) Exceptional items

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 2018 is a credit of £2,948,000 (2017: £367,000).

In 2017, exceptional items are £300,000 of refinance costs and £1,215,000 of redundancy, other personnel and property dilapidations costs relating to the reorganisation of subsidiaries acquired in 2016. There were also exceptional finance costs of £524,000 relating to refinancing.

3 (c) Other operating income

Other operating income represents termination fee income.

4 Particulars of employees

The average number of staff employed by the Group during the financial year, including Executive Directors, by activity was:

	2018 Number	2017 Number
Administrative staff	263	188
Operational staff	602	563
Sales staff	3	3
IT staff	45	35
Directors (excluding 3 (2017: 3) Non-executive Directors)	2	2
	915	791

The aggregate payroll costs, including Executive Directors, of the employees were:

	2018 £'000	2017 £'000
Wages and salaries	29,993	26,615
Social security costs	3,047	2,754
Staff pension costs	638	400
Share-based payment (note 22)	1,208	446
Director pension costs	8	9
	34,894	30,224

5 Finance costs and finance income

	2018 £'000	2017 £'000
Finance costs		
Bank loans and overdrafts	4,962	4,134
Hire purchase	—	3
Total pre-exceptional finance costs	4,962	4,137
Exceptional finance costs	996	524
Total finance costs	5,958	4,661
Finance income		
Bank interest receivable	224	21
Total finance income	224	21

6 Taxation

	2018 £'000	2017 £'000
Analysis of charge in the year		
Current tax:		
Current income tax expense	(127)	971
Adjustment to tax charge in respect of previous periods	(37)	(83)
Total current income tax	(164)	888
Deferred tax:		
Origination and reversal of temporary differences	1,056	2,705
Adjustment to tax charge in respect of prior periods	(5)	(287)
Tax on profit	887	3,306

The charge for the period can be reconciled to the profit per the consolidated statement of comprehensive income as follows:

Profit before tax	5,351	17,965
Tax at the UK corporation tax rate of 19.00% (2017: 19.25%)	1,017	3,458
Expenses not deductible for tax purposes	40	(7)
Deferred tax not recognised	—	2
Adjustments to tax charge in respect of previous periods	(43)	140
Change in tax rate	(127)	(287)
Tax expense in the income statement	887	3,306

Current tax credit through equity in the year was £85,000 (2017: £97,000).

7 Earnings per share (EPS)

The calculation of EPS is based on the following data and number of shares:

	2018 £'000	2017 £'000
Profit for the year used for calculation of basic EPS	4,464	14,659
Number of shares	2018	2017
Weighted average number of ordinary shares for the purposes of basic EPS	112,408,338	90,655,868
Effect of potentially dilutive ordinary shares (restated):		
– share options	1,056,897	1,127,750
Weighted average number of ordinary shares for the purposes of diluted EPS	113,465,235	91,783,618
EPS:		
– basic (pence)	3.97	16.17
– diluted (pence)	3.93	15.97

8 Dividends

	Year ended 31 December 2018 £'000	Year ended 31 December 2018 Per share (pence)	Year ended 31 December 2017 £'000	Year ended 31 December 2017 Per share (pence)
Paid final dividend	3,892	3.46	2,452	2.73
Paid interim dividend	2,251	2.00	1,576	1.74
Total dividends	6,143	5.46	4,028	4.47

A final cash dividend for 2018 of 3.98p per share (2017: 3.46p) has been declared by the Directors and will be paid in June 2019. These dividends amount to £4,479,000 and will be accounted for in 2019. Including the interim dividend for 2018 of 2.00p per share (2017: 1.74p), this gives a full-year dividend for 2018 of 5.98p per share (2017: 5.20p).

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 2018 the distributable profits in the parent company of £2,565,000 are not adequate to cover the proposed final dividend of £4,479,000. In accordance with UK law, interim financial statements for the parent company as at 31 March 2019 have been filed and include a further intercompany dividend of £10,000,000 from a subsidiary undertaking to increase the company's distributable reserves to £12,513,000. These interim financial statements are the relevant accounts by which permissibility of the final dividend is referenced. No modification has thus been made to the final proposed dividend.

9 Intangible assets

	Goodwill £'000	Customer contracts £'000	Development £'000	Software £'000	Total £'000
Cost					
As at 1 January 2017	7,609	2,166	2,514	7,911	20,200
Additions	—	—	206	1,210	1,416
Disposals	—	—	—	(28)	(28)
As at 31 December 2017	7,609	2,166	2,720	9,093	21,588
Additions	—	—	336	5,551	5,887
Disposals	—	—	—	(22)	(22)
As at 31 December 2018	7,609	2,166	3,056	14,622	27,453
Amortisation					
As at 1 January 2017	—	1,430	470	3,689	5,589
Charge for year	—	171	159	1,820	2,150
Disposals	—	—	—	(21)	(21)
As at 31 December 2017	—	1,601	629	5,488	7,718
Charge for year	—	433	544	1,620	2,597
As at 31 December 2018	—	2,034	1,173	7,108	10,315
Net book value					
As at 31 December 2018	7,609	132	1,883	7,514	17,138
As at 31 December 2017	7,609	565	2,091	3,605	13,870
As at 1 January 2017	7,609	736	2,044	4,222	14,611

10 Property, plant and equipment

	Freehold/ leasehold property £'000	Meter assets £'000	Plant and machinery £'000	Fixtures, fittings and equipment £'000	Motor vehicles £'000	Total £'000
Cost						
As at 1 January 2017	2,239	180,622	87	2,108	169	185,225
Additions	61	122,527	255	1,020	1	123,864
Disposals	—	(3,334)	(25)	(63)	(87)	(3,509)
As at 31 December 2017	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
Depreciation						
As at 1 January 2017	263	25,495	22	1,340	128	27,248
Charge for year	129	13,312	56	540	24	14,061
Disposals	—	(987)	(7)	(12)	(69)	(1,075)
As at 31 December 2017	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
Net book value						
As at 31 December 2018	2,017	350,362	271	1,630	2,452	356,732
As at 31 December 2017	1,908	261,995	246	1,197	—	265,346
As at 1 January 2017	1,976	155,127	65	768	41	157,977

Meter assets have been disclosed separately, previously disclosed within plant and machinery, to align with management reporting. Included within the closing meter assets net book value of £350,362,000 (2017: £261,995,000) is £43,049,000 (2017: £56,570,000) relating to the traditional meter portfolio. In accordance with our accounting policy these assets will be written down to zero by 2022. In the 2018 consolidated financial statements the traditional meter portfolio generated £13,216,000 revenue with a corresponding £4,682,000 depreciation charge. £12,853,000 annualised recurring revenue as at 31 December 2018 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 standalone 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
- a pre-tax discount rate of 2.75%, 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 carrying value of the traditional meter assets CGU exceeded the value in use. As a result, an impairment charge of £5.6m has been recognised.

Based on sensitivity analysis performed by management, with other variable components held constant:

- a 1% increase or decrease in estimated future termination income gives rise to a £0.28m change in the impairment charge;
- a 0.5% increase or decrease in the pre-tax discount rate gives rise to a £0.43m change in the impairment charge; and
- if the end date of the smart meter rollout is flexed by six months, this results in a change in the impairment charge of approximately £1.0m.

No impairment on other meter assets was recognised in 2018.

11 Financial asset investments

	Shares in Group undertaking £'000	Unlisted investments £'000	Total £'000
Cost			
As at 1 January 2018	43	75	118
Impairment	(43)	—	(43)
As at 31 December 2018	—	75	75

The amount impaired represents the impairment of a subsidiary undertaking, SMS Italia SRL. The amount written off represents the original purchase price. These shares in Group undertakings were previously not consolidated on the basis that they were not material to the Group.

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
As at 31 December 2017 and 31 December 2018				
Goodwill	4,112	3,497	—	7,609

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 three-year period. These budgets and forecasts have regard to historic 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 annual impairment test was performed for the two 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 2.0% (2017: 2.0%). This is prudently aligned with the rate of inflation and is not considered to be higher than the average long-term industry growth rate. This long-term growth rate is common to both CGUs.
- **Discount rate** – the discount rate is based on the weighted average cost of capital (WACC) which would be anticipated for a market participant investing in the Group. This rate reflects the time value of money, the Group’s risk profile and the impact of the current economic climate. The pre-tax discount rate is 7.2% (2017: 10.25%) and the post-tax discount rate is 5.9% (2017: 8.2%).

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 any key assumptions that would cause the carrying amounts of goodwill to exceed the value in use for either CGU.

13 Inventories

	2018 £'000	2017 £'000
Finished goods	10,728	16,049
Consumables	533	526
	11,261	16,575

14 Trade and other receivables

	2018 £'000	2017 £'000
Trade receivables	17,582	10,959
Prepayments	1,090	1,421
Accrued income	10,454	9,812
Other receivables	944	1,263
VAT recoverable	570	1,827
	30,640	25,282

Trade receivables and accrued income include billed and unbilled receivables relating to our meter rental contracts.

Amounts falling due after more than one year:

	2018 £'000	2017 £'000
Accrued income	402	594

Accrued income is made up of the following balances:

	2018 £'000	2017 £'000
Unbilled receivables	10,432	9,601
Contract assets	22	211
	10,454	9,812

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 2018 was £3,112,000 (2017: £2,316,000). See note 18 for further details. The ageing profile of trade receivables past due date is shown below:

	2018 £'000	2017 £'000
31–60 days	1,761	2,572
61–90 days	1,662	114
Over 90 days	2,719	3,055
	6,142	5,741
Loss allowance	(2,356)	(1,812)
	3,786	3,929

Trade receivables are non-interest bearing and are generally on 30–90-day terms. Trade receivables due from related parties at 31 December 2018 amounted to £Nil (2017: £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:

	2018 £'000	2017 £'000
Cash	30,027	150,600
	30,027	150,600

16 Trade and other payables

	2018 £'000	2017 £'000
Current		
Trade payables	13,835	23,923
Other payables	775	1,396
Other taxes	2,628	2,718
Deferred income	3,540	2,311
Advance payments	1,345	2,032
Accruals	14,225	15,802
	36,348	48,182

Deferred income and advance payments are made up of the following balances:

	2018 £'000	2017 £'000
Contract liabilities	3,229	3,623
Other deferred income	1,656	720
	4,885	4,343

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

Trade payables are classified at amortised cost and are non-interest bearing and are normally settled on 30–45-day terms.

All trade liabilities are denominated in Sterling.

17 Bank loans and overdrafts

	2018 £'000	2017 £'000
Current		
Bank loans	172,016	23,197
	172,016	23,197
Non-current		
Bank loans	—	163,887
	—	163,887

Bank loans at 31 December 2018 relate to a revolving credit facility of £280m (the existing facility). In November 2017, SMS agreed a refinancing of this facility with its existing syndicate of banks. This extended debt facility extended the maturity date of the existing facility from March 2019 to November 2020 on similarly attractive terms to the existing facility. The extension of the facility resulted in £0.5m of finance costs that were expensed through the consolidated income statement as exceptional in the year ended 31 December 2017. The loan attracts interest at a rate of 1.85% over the three-month LIBOR. 0.65% is paid on undrawn funds. The syndicate of banks comprise Barclays Bank plc, Santander UK plc, HSBC UK, Clydesdale Bank plc and Bank of Scotland plc. The banks have a bond and floating charge over current and future property and assets.

Accrued interest on the loan balance is recognised separately in accruals, within trade and other payables (Note 16).

The Group has complied with the financial covenants of its borrowing facility during the 2018 and 2017 reporting period.

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 discharges the Group's obligations under the existing facility with effect from the first utilisation on 3 January 2019. It is thus deemed to be an extinguishment. As at 31 December 2018 the existing facility was still outstanding and the total balance of £172.0m has been classified as current. In addition to this, £0.02m of accrued interest has been recognised within trade and other payables. Unamortised arrangement fees on the existing facility of £0.36m have been accelerated and recognised as an exceptional finance cost in the consolidated income statement together with £0.63m of legal and professional fees attributable to the extinguishment.

No drawdowns had been made under the new facility at 31 December 2018 and, therefore, transaction costs payable of £3.1m have been deferred within other assets at 31 December 2018. These will be reclassified to bank loans, and subsequently amortised over the term of the new facility, with effect from 3 January 2019.

17 (a) Changes in liabilities arising from financing activities

	2018 £'000	2017 £'000
Brought forward at 1 January	187,084	102,176
New borrowings	101,627	104,075
Borrowings repaid, including arrangement fees paid	(117,281)	(19,378)
Amortisation of arrangement fees	586	211
Carried forward at 31 December	172,016	187,084

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:

Interest rate risk

The Group's interest rate risk generally arises from its long and short-term borrowing facilities. As at 31 December 2018, all borrowings are considered short term since the existing loan will be extinguished on 3 January 2019 upon commencement of the

new revolving credit facility agreement (note 17). A sensitivity analysis was still performed on the loan balance outstanding at 31 December 2018 on the basis that this will be replaced by the new loan facility which will be subject to future interest rate risk.

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
2018	+70bps	(1,204)
2017	+70bps	(741)

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.

Interest rate risk profile of financial liabilities

The interest rate profile of the financial liabilities of the Group (being bank loans and overdrafts) as at each period end is as follows:

	Variable rate financial liabilities £'000
2018¹	172,016
2017	206,568

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.

Interest rate risk profile of financial assets

The Group's financial assets at 31 December 2018 comprise cash and trade receivables. The cash balance of £30,027,000 (2017: £150,600,000) is a floating rate financial asset.

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.

Foreign currency risk

The Group's exposure to the risk of changes in foreign exchange is insignificant as primarily all of the Group's operating activities are denominated in Pounds Sterling.

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 liabilities is covered within the relevant liability note or below.

	2018¹ £'000	2017 £'000
Variable rate		
Less than one year	172,016	27,500
Two to five years	—	104,664
Over five years	—	74,404
	172,016	206,568

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.

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.

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 £28,438,000 (2017: £21,365,000) 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.

Impairment of financial assets

The Group has two types of financial assets that are subject to IFRS 9's new expected credit loss model:

- trade receivables, which consist of billed receivables arising from contracts with customers and operating leases, 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 and operating leases.

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, lease rentals 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 a period of twelve months before 31 December 2018 or 1 January 2018 respectively 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 provision on trade receivables at 31 December 2018, an adjustment was made to increase the historical loss rates in recognition of the number of independent energy suppliers that have gone into administration during the year for which outstanding invoices are unlikely to be recoverable.

On that basis, the loss allowances as at 31 December 2018 and 1 January 2018 (on adoption of IFRS 9) were determined as £3,112,000 and £2,316,000 respectively for trade receivables and accrued income. A reconciliation of these balances is provided as follows:

	Accrued income £'000	Trade receivables £'000	Total £'000
At 31 December 2017 – calculated under IAS 39	455	1,812	2,267
Amounts restated through opening retained earnings	—	49	49
At 1 January 2018 – calculated under IFRS 9	455	1,861	2,316
Increase in loss allowance recognised in profit or loss during the year	523	2,065	2,588
Receivables written off during the year as uncollectable	—	(1,570)	(1,570)
Unused amount reversed	(222)	—	(222)
At 31 December 2018 – calculated under IFRS 9	756	2,356	3,112

The increase in the loss allowance on trade receivables has arisen due to the number of new, typically smaller, independent energy companies that have gone into administration during 2018, for which amounts are considered unrecoverable, together with the impact of IFRS 9. There was no material movement in the loss allowance on accrued income. Total net impairment losses on financial and contract assets were £2,409,000 in 2018 (2017: £704,000). Of this amount, £2,366,000 (2017: £704,000) relates to amounts arising from trade receivables and accrued income. The balance of £43,000 relates to the impairment of an investment in a subsidiary undertaking (see note 11).

Fair value

There is no material difference between the book value and the fair value of any financial asset or liability.

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.

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 is to provide a progressive, through-cycle dividend that reflects the potential volatility of our business.

19 Deferred taxation

The movement in the deferred taxation liability during the period was:

	2018 £'000	2017 £'000
Opening deferred tax liability	9,924	7,885
Increase in provision through consolidated statement of comprehensive income	1,052	2,418
Increase/(decrease) in provision through equity	1,094	(379)
Closing deferred tax liability	12,070	9,924

The Group's provision for deferred taxation consists of the tax effect of temporary differences in respect of:

	2018 £'000	2017 £'000
Excess of taxation allowances over depreciation on property, plant and equipment	12,170	11,559
Tax losses available	(96)	(61)
Deferred tax asset on share options	(1,056)	(1,998)
Deferred tax on intangibles acquired	147	427
Other	905	(3)
	12,070	9,924

The deferred tax included in the consolidated statement of comprehensive income is as follows:

	2018 £'000	2017 £'000
Accelerated capital allowances	613	2,431
Tax losses	(35)	204
Deferred tax asset on share options	(152)	22
Movement in fair value of intangibles	(280)	(252)
Other	906	13
	1,052	2,418

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.

20 Related party transactions

20 (a) Subsidiaries

The Group's subsidiaries at 31 December 2018 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 management
SMS Meter Assets Limited	1	Ordinary shares	100%	Gas utility management
SMS Data Management Limited	1	Ordinary shares	100%	Data management
UKMA (AF) Limited*	2	Ordinary shares	100%	Leasing
SMS Energy Services Limited	2	Ordinary shares	100%	Electricity utility management
SMS Italia SRL**	3	Ordinary shares	100%	Electricity utility management
CH4 Gas Utility and Maintenance Services Limited	2	Ordinary shares	100%	Meter installation
Trojan Utilities Limited	2	Ordinary shares	100%	Meter installation
Qton Solutions Limited	2	Ordinary shares	100%	Business and domestic software development

* The shareholding in this company is indirect via a subsidiary company.

** This company was wound up during 2018; the shareholding was indirect via a subsidiary company.

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: Via Gaudenzio Ferrari, 21/C 21047 Saronno VA, Italy.

20 (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:

	2018 £'000	2017 £'000
Short-term employee benefits	2,369	2,058
Post-employment benefits	23	15
Share-based payments	114	105
	2,506	2,178

20 (c) Directors

(i) Directors' emoluments

Aggregate remuneration for both Executive and Non-executive Directors in respect of qualifying services was:

	2018 £'000	2017 £'000
Aggregate emoluments	1,281	1,046
Company contributions to money purchase pension scheme	8	4
Company contributions to private pension plan ¹	—	1
	1,289	1,051

¹ A pension contribution was paid into a private pension plan for the CEO.

In 2018, no amount was payable to Directors as settlements following resignation (2017: £139,605 payable to two Directors).

(ii) *Emoluments of highest paid Director*

	2018 £'000	2017 £'000
Emoluments	663	619
Company contributions to money purchase pension scheme	—	1
	663	620

(iii) *Number of Directors who accrued benefits under Company pension schemes*

	2018 Number	2017 Number
Money purchase schemes	1	2

20 (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 £41,615 (2017: £49,800) 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 (2017: £8,300) was outstanding in this regard.
- The Group paid dividends to Alan Foy of £244,641 (2017: £320,973), The Metis Trust¹ of £49,140 (2017: £Nil), David Thompson of £27 (2017: £Nil), Miriam Greenwood of £893 (2017: £723), Willie MacDiarmid² of £323 (2017: £265), Graeme Bissett of £289 (2017: £237) and Kelly Olsen of £27 (2017: £Nil).
- At the year end Trojan Utilities Limited had a balance with Utilities Academy Limited of £26,442 (2017: £26,442) with transactions during the year amounting to £Nil (2017: £3,165). Utilities Academy Limited is a smart meter training facility in which a subsidiary company of the Group holds a minority shareholding.

1 Alan Foy is a trustee but not a beneficiary.

2 Paid to a connected person.

21 Share capital

	2018 £'000	2017 £'000
Allotted and called up:		
112,548,050 ordinary shares of £0.01 each (2017: 112,450,800 ordinary shares of £0.01 each)	1,125	1,124

During the year 97,250 (2017: 1,222,563) ordinary share options were exercised in relation to the Group's employee share plans which are described in note 22. The ordinary shares issued have a nominal value of £973 (2017: £12,226), and aggregate consideration of £270,001 (2017: £1,985,487) was received.

On 24 November 2017 the Company completed a placing of new shares (21,739,131 ordinary shares at 690p per ordinary share) to raise gross proceeds of £150m.

The Group's Share Incentive Plan is administered by the Smart Metering Systems SIP Trust (the trust), who acquire shares in SMS (own shares) to satisfy awards under this plan and facilitate the delivery of shares to participants. At 31 December 2018, 111,307 (2017: 110,779) own shares were held in trust with a market value of £584,000 (2017: £969,000). The Company purchased 36,137 shares (2017: 40,484) from the market during 2018 with a weighted average fair value of £6.34 per share (2017: £6.78).

22 Share-based payments

22 (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, Executive Director or Non-executive Director 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 2018	Granted	Exercised	Forfeited	Expired	At 31 December 2018	Exercise price (pence)	Date exercisable	Expiry date	Fair value at grant (pence)
CSOP	28,453	—	(1,200)	—	—	27,253	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	450,000	—	(45,000)	—	—	405,000	153.5	28 May 2017	28 May 2022	40.0
Unapproved	65,000	—	—	—	—	65,000	350.0	31 Dec 2018	12 Nov 2024	84.8
Unapproved	717,285	—	—	(25,213)	—	692,072	350.0	12 Nov 2019	12 Nov 2024	84.8
Unapproved	299,349	—	(51,050)	(82,575)	(4,000)	161,724	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	158,004	—	—	(61,446)	(5,852)	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	9,090	—	—	—	—	9,090	550.0	28 Nov 2021	28 Nov 2026	141.0
Unapproved ¹	—	489,001	—	—	—	489,001	700.0	1 Jan 2023	13 Jul 2028	125.2
Total	2,237,433	489,001	(97,250)	(169,234)	(9,852)	2,450,098				

¹ Options granted on 13 July 2018 of 489,001 relate to only the first of five tranches of shares. 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 2018 was £7.59 (2017: £6.20).

(ii) Fair value of options granted

The assessed fair value at grant date of options granted during the year ended 31 December 2018 was 125.2p (2017: not applicable). 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.

The following table lists the range of assumptions applied to the options granted under the Unapproved Plan during the year ended 31 December 2018:

Dividend yield (%)	1.0%
Expected volatility (%)	30.0%
Risk-free interest rate (%)	1.025%
Expected option life (years)	5
Exercise price (£)	7.00
Share price at grant date (£)	6.95
Fair value at grant date (£)	1.25

As 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. 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 2018 for all options is £281,596.

22 (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 2018	Awarded shares	Sold/transferred	Forfeited	At 31 December 2018	Weighted average acquisition price
Partnership	124,328	49,565	(14,932)	—	158,961	£5.24
Matching	123,178	49,565	(7,496)	(7,623)	157,624	£5.24
Dividend	2,762	1,034	(179)	—	3,617	£5.24
Total	250,268	100,164	(22,607)	(7,623)	320,202	

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 2018 was approximately £6.56 per share (2017: £6.65). 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 2018 for all Matching Shares is £205,964. No expense is recognised for the Partnership Shares and Dividend Shares because the participants pay full market value for these shares.

23 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.

24 Commitments under operating leases

The Group has entered into commercial leases for vehicles, office space and various items of office equipment. These leases have lives between one and 15 years and some have renewal options included in the contracts. There are no restrictions placed upon the Group by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at each year end are as follows:

	2018 £'000	2017 £'000
Future minimum commitments under operating lease agreements are as follows:		
Payable within one year	1,258	1,262
Payable within two and five years	2,841	1,884
Payable after five years	861	477
	4,960	3,623

25 Capital commitments

The Group has significant capital expenditure contracted for at the end of the reporting period but not recognised as liabilities of £2,430,000 in relation to the implementation of a new ERP system across the Group. In 2017 the Group had no capital commitments.

26 Ultimate controlling party

There is no ultimate controlling party by virtue of the structure of shareholdings in the Group.

27 Post balance sheet events

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 arrangement extinguished the Group's obligations under the existing facility with effect from the first utilisation on 3 January 2019, at which point £200m was drawn down under the new facility. As at 31 December 2018, therefore, the existing facility was still outstanding and the total balance of £172.0m has been classified as current. See note 17 for further details.

28 Impact of change in accounting policies on the financial statements

This note explains the impact of the adoption of IFRS 9 and IFRS 15 on the Group's financial statements.

28 (a) Impact on the financial statements

Because of the changes in the entity's accounting policies, prior year financial statements had to be restated. As explained in notes 28 (b) and 28 (c) below, IFRS 9 and IFRS 15 were both adopted on a modified retrospective basis and therefore comparative information has not been restated. The reclassifications and adjustments arising from the new rules are therefore not reflected in the consolidated balance sheet as at 31 December 2017 but are recognised in the opening consolidated balance sheet on 1 January 2018.

The following table shows the adjustments recognised for each individual line item. Line items that were not affected by the changes have not been included. As a result, the subtotals and totals disclosed cannot be recalculated from the numbers provided. The adjustments are explained in more detail by standard below.

	31 December 2017 as originally presented £'000	IFRS 9 £'000	1 January 2018 restated £'000
Balance sheet (extract)			
Trade and other receivables	26,302	(49)	26,253
Retained earnings	59,040	(49)	58,991

There were no adjustments to individual line items as a result of the adoption of IFRS 15.

The adjustments are explained in more detail by standard below.

28 (b) IFRS 9

IFRS 9 replaces the provisions of IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting. The adoption of IFRS 9 from 1 January 2018 resulted in changes in accounting policies and adjustments to the amounts recognised in the financial statements. The new accounting policies are set out in the accounting policies section above. In accordance with the transitional provisions in paragraphs 7.2.15 and 7.2.26 of IFRS 9, comparative figures have not been restated.

The total impact on the Group's retained earnings as at 1 January 2018 is as follows:

	£'000
Retained earnings at 31 December 2017 as originally presented	59,040
Adjustment to retained earnings from adoption of IFRS 9 on 1 January	(49)
Restated retained earnings at 1 January 2018	58,991

The adjustment to retained earnings relates to an increase in the loss allowance provision for trade receivables and accrued income upon adoption of the new impairment rules under IFRS 9. See further details in section (i) below.

(i) Classification and measurement

On 1 January 2018 (the date of initial application of IFRS 9), management has assessed which business models apply to the financial assets held by the Group and has classified its financial instruments into the appropriate IFRS 9 categories.

The main effect resulting from this is the reclassification of debt investments of £74,000 from held to maturity to amortised cost. There was no difference between the previous carrying amount and the revised carrying amount at 1 January 2018 to be recognised in opening retained earnings.

The classification of all other financial assets, which consists of cash and cash equivalents and trade and other receivables, has remain unchanged upon adoption of IFRS 9 on 1 January 2018. These continue to be classified as investments held at amortised cost.

(ii) Impairment of financial assets

Refer to the accounting policies and note 18 for details on the Group's financial assets that are subject to IFRS 9's new expected credit loss model.

The Group was required to revise its impairment methodology under IFRS 9 for each of these classes of assets. The impact of the change in impairment methodology on the Group's retained earnings and equity is disclosed in the table in section (a) above. Note 18 (financial risk management) provides further details about the approach and calculation of the loss allowance for trade receivables and accrued income.

(iii) Refinancing

In 2017, the Group refinanced its existing revolving credit facility on two occasions in March 2017 and November 2017 respectively to increase the total facility amount available and to extend the maturity date of the facility from March 2019 to November 2020. In exchange, arrangement fees were paid. There were no changes to the interest payable or loan repayment schedules of the drawdowns. In accordance with paragraph AG62 of IAS 39, the modifications to the facility were not considered to result in an extinguishment of the initial borrowings. Neither modification altered the cash flows of the individual loans drawn down and thus the effective interest rate remained unchanged. There was no impact upon adoption of IFRS 9 and no adjustment was required within brought forward retained earnings at 1 January 2018.

28 (c) IFRS 15

The Group has adopted IFRS 15 Revenue from Contracts with Customers from 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts recognised in the financial statements. The new accounting policies are set out in note 2. In accordance with the transitional provision in paragraph C3(b) of IFRS 15, comparative figures have not been restated.

Under this transition method, the Group has elected to only apply the new standard retrospectively to contracts that were not completed contracts at the date of initial application on 1 January 2018.

There was no impact on the Group's retained earnings at 1 January 2018.

There was also no impact to amounts recognised in the balance sheet at the date of initial application. However, certain components within trade and other receivables and trade and other payables have been further analysed in order to meet the disclosure requirements of IFRS 15. Refer to notes 14 and 16 for these supplementary disclosures.

As IFRS 15 has been applied on a modified retrospective basis, the Group has disclosed in the table below the amount by which each financial statement line item in the primary financial statements is affected in 2018 by the application of IFRS 15 as compared to IAS 18. Only those financial statement line items that have been impacted have been disclosed.

	IAS 18 amount £'000	Remeasurement adjustment ⁽ⁱ⁾ £'000	IFRS 15 amount £'000
Income statement			
Revenue	97,415	1,077	98,492
Cost of sales	(56,508)	(437)	(56,945)

	IAS 18 amount £'000	Remeasurement adjustment ⁽ⁱ⁾ £'000	IFRS 15 amount £'000
Balance Sheet			
Trade and other payables	36,988	(640)	36,348

(i) Remeasurement

As a result of the adoption of IFRS 15, there has been just one measurement impact in relation to utility connections services. Previously, under IAS 18, revenue was deferred at the point of upfront payment by the customer and subsequently recognised in the consolidated income statement upon delivery of the service. Costs were also deferred until completion of the service. Under IFRS 15, these contracts contain a single performance obligation to deliver an end-to-end connection service over time. Revenue is thus recognised based on the progress measurement method detailed in the accounting policies in note 2. Costs are expensed as incurred, to the extent they do not meet the definition of a fulfilment cost under IFRS 15. As a result, the adjustment in the tables above is to recognise the release of revenue and costs related to incomplete contracts, in accordance with progress measured. There is a corresponding impact on deferred income and accruals respectively, both recognised within trade and other payables.