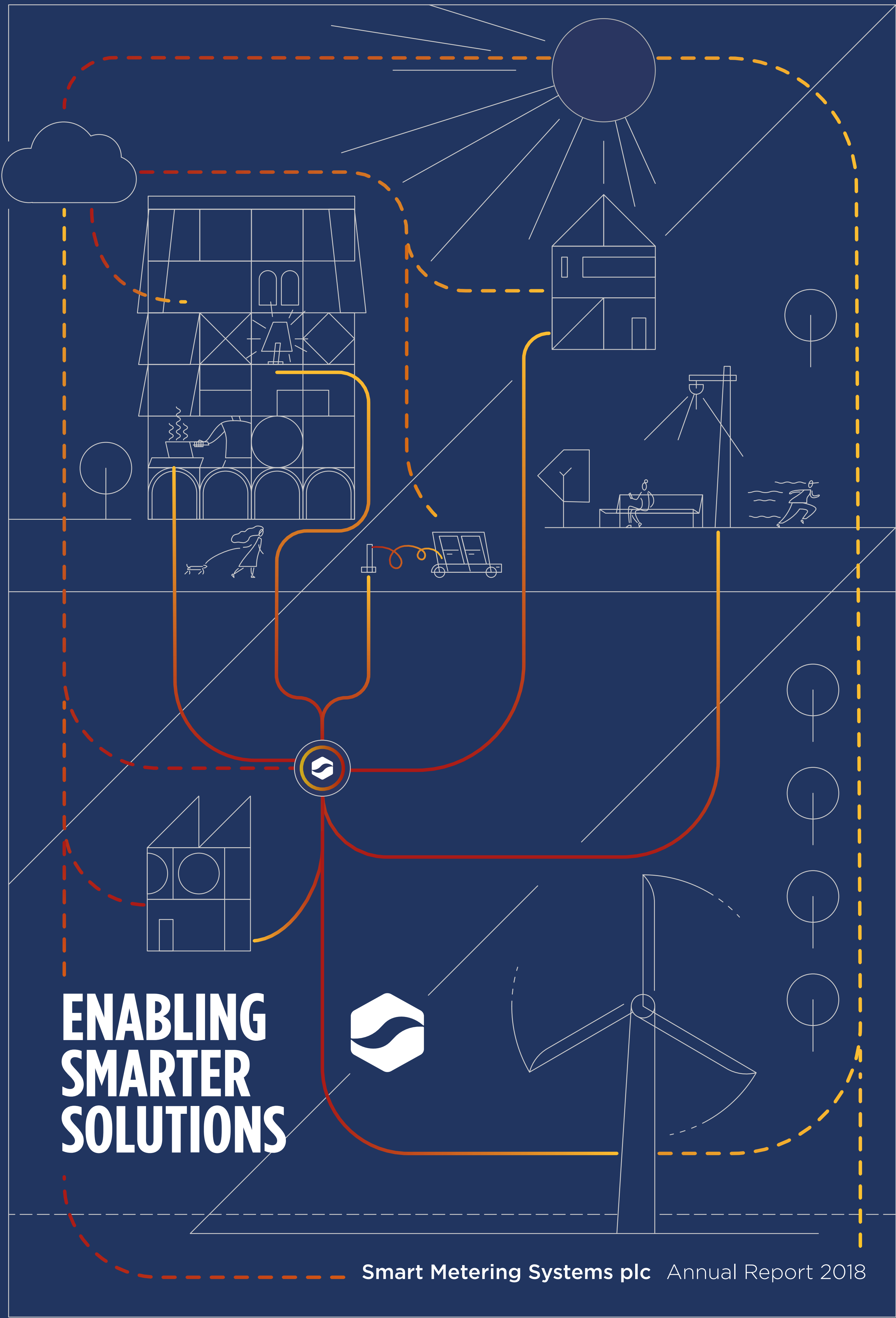


ENABLING SMARTER SOLUTIONS

Smart Metering Systems plc Annual Report 2018

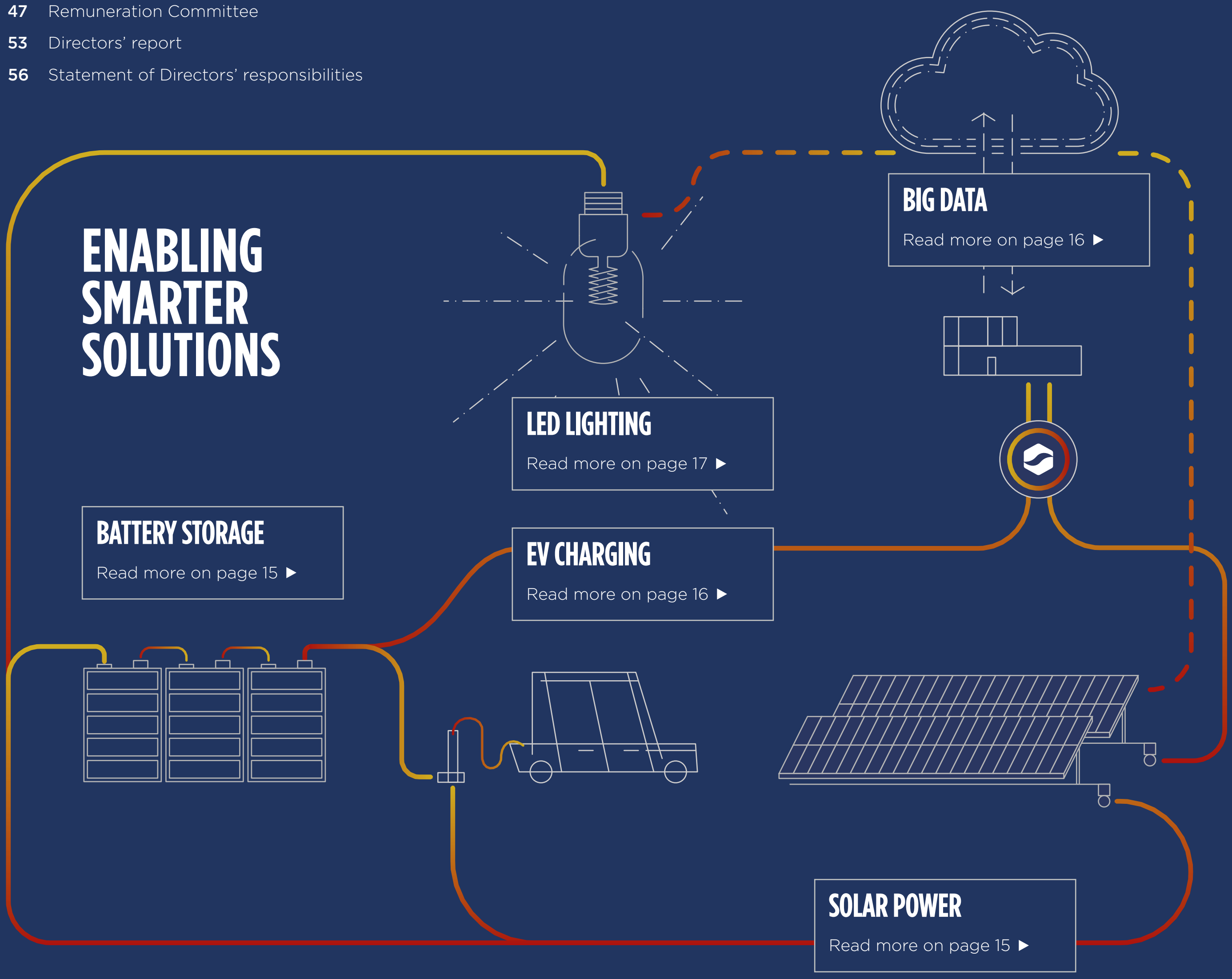
STRATEGIC REPORT

CORPORATE GOVERNANCE

FINANCIAL STATEMENTS

Read more about SMS on our investor website

sms-plc.com/corporate



53 million
smart meters to be installed

15 million
smart meters already installed

38 million
smart meters still to be installed

CAPACITY FOR GROWTH

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

1 Partner contacts one of our call centres →

2 Engagement with customer services →

3 Smart meter asset installation by SMS employees →

4 Ongoing asset management and data collection

2 training centres

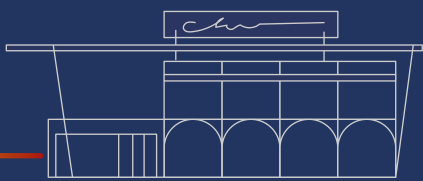
12 locations

964 staff

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

Our partners

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



Enterprises
- Retail chains
- Large supermarkets
- High street banks
- Telecoms companies
- Public sector organisations
- I&C businesses

A trusted partner providing the complete energy service, we connect, own, operate and maintain metering systems and databases on behalf of energy suppliers, as well as delivering metering, energy management and utility connection services directly to large energy consumers and multi-site organisations.

Our fully integrated energy service covers:

Asset installation

Design, installation and management of utility connections and energy infrastructure

Read more 18 & 19

Asset management

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

Read more 20 & 21

Energy management

Delivery of ongoing energy management and carbon reduction solutions

Read more 22 & 23

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

What sets us apart?

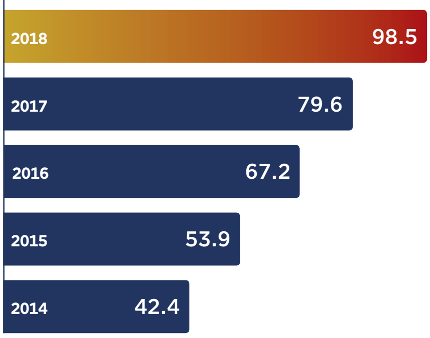
- Track record and experience
- Proven management team
- In-house trained and skilled workforce
- Knowledge and expertise
- In-house IT infrastructure
- Big data capability
- Strong market-leading partnerships
- Best-in-class customer service

A strong financial performance

Revenue (£m)

£98.5m

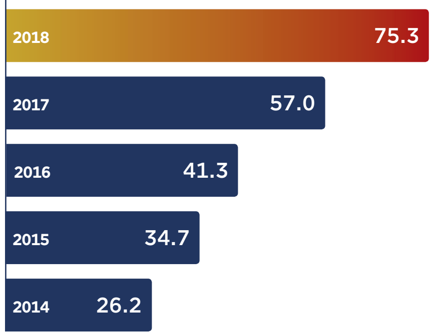
+24%



Annualised recurring revenue[1] (£m)

£75.3m

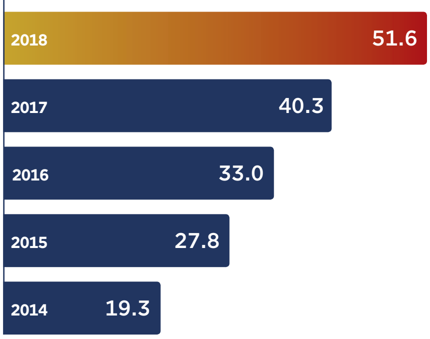
+32%



Pre-exceptional EBITDA[1] (£m)

£51.6m

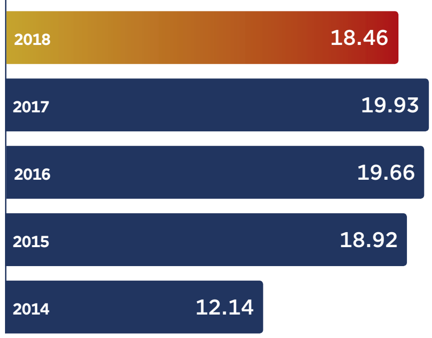
+28%



Underlying earnings per share[1] (p)

18.46p

-7%



1 Refer to page 27 for definitions and details on the Group's alternative performance measures.

Financial highlights

- Revenue increased by 24% to £98.5m (2017: £79.6m)
- Total annualised recurring revenue[1] 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 EBITDA[1] increased by 28% to £51.6m (2017: £40.3m)
- Underlying PBT[1] 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 share[1] 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)

"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."

Alan Foy
Chief Executive Officer

Building on solid foundations

By investing in smart meters, we are establishing the foundations for a business at the centre of the energy system.

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.

Willie MacDiarmid
Non-executive Chairman
4 April 2019

Delivering the future of smart energy

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.

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 long-standing 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.

32%

increase in annualised long-term index-linked recurring revenue

932,000

smart meters as at April 2019

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 the 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.

Alan Foy
Chief Executive Officer
4 April 2019

Positioned to leverage our capabilities and grow our service proposition

Key business focus

An experienced in-house national workforce undertakes comprehensive meter installation replacement and safety review activity. An automated field data capture system is employed to validate data and ensure its accuracy, eliminating future billing errors.

Asset installation

Nationwide field force management and asset installation, focusing always on safety, quality and delivery of customer portfolios

Managing multi-utility infrastructure projects

Key strategic priorities
Target the domestic smart meter opportunity.

Our current position in 2018
Substantial, safe, skilled workforce in place to install domestic smart meters.

Continued investment in infrastructure and delivery capability.

Our focus for 2019
Continue to grow and build capacity, lead and drive innovation.

Deliver efficiency improvement.

Manage the transition to SMETS2 smart meters as safely as possible.

Our potential for 2020 and beyond
Continue to increase installation capacity organically through our established in-house training centres and align to our customer requirements.

SMS aims to develop its capacity to play a leading role in the wider establishment of national green energy infrastructure.

Asset management

Investing in assets and providing remote reading and data solutions

Key strategic priorities
Increase growth rate of meter assets portfolio and drive recurring revenue.

Our current position in 2018
54% increase in meter and data portfolio to 3.13 million assets.

32% increase in annualised recurring revenue to £75.3m.

Our focus for 2019
Increase asset portfolio and annualised recurring revenues and ensure full life cycle asset management.

Our potential for 2020 and beyond
SMS will continue to secure and maximise market share in the addressable market for ownership of smart meters in the UK and provide smart data services.

Energy management

Reducing customers' carbon footprint, energy consumption and costs

Key strategic priorities
Focus on cross-selling and establishing additional energy asset opportunities.

Our current position in 2018
Processed and analysed around 400,000 billing points. Managed energy consumption on over 3,500 sites, which equates to c.1,400 GWh of energy.

Our focus for 2019
Increase activities across all processes and services to new and existing Group customers and energy strategies for the evolving energy market post-smart metering.

Our potential for 2020 and beyond
SMS believes the UK energy market will undergo significant change in pursuit of the costs and CO_2 reductions. SMS aims to provide investment in new utility and energy reduction assets which will be required, along with energy expertise, technology and data services.

Our integrated service business model

Our strengths

Market potential
There are over 30 million premises in the UK representing c.53 million gas and electricity meters that will be changed during the smart meter programme, of which approximately 14.9 million were exchanged by December 2018. The non-domestic smart meter rollout (of which just over a million devices have been installed) covers approximately 2 million sites. Every installed electricity smart meter will also require data services for the purposes of settlement and provides additional energy service opportunities.

Read more 14 – 17

People
Our complete energy service is supported by our in-house engineering and expert consultancy workforce across the UK. This extensive industry knowledge allows us to make smart decisions about all aspects of our customers' projects.

Read more 28 & 29

IT systems
We have significant IT software and data security capabilities and capacity and the ability to develop new applications and technologies to the ongoing benefit of our customers.

Customer relationships
Enjoying long-standing multi-level relationships with energy suppliers and the UK Industrial and Commercial sector, the enduring partnerships we maintain with our customers are testament to our unrivalled support, extensive industry knowledge and commitment to providing successful, innovative and forward-thinking energy solutions.

Our business

Our business model is based on connecting, owning, operating and maintaining metering systems and databases on behalf of energy suppliers, as well as downstream energy and environmental management services for large energy consumers and multi-site organisations. Our fully integrated service is tailored to customers in the gas and electricity connection, meter and energy services markets.

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

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

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

Supported by

Capital investment
We maintain strong relationships with our banking business partners which work with us to facilitate our growth plans. On 21 December 2018 a new banking facility was signed, providing the business access to £420m over the next five years. This provides certainty and flexibility by providing significant additional financial capacity to take advantage of further opportunities in the UK domestic smart meter rollout.

Strategic acquisitions
Acquisition of UPL in 2014 allowed us to offer a dual fuel solution, with the integration of electric meter asset installation, ownership and data business services. Acquisitions in 2016 allowed us to obtain control over the installation element of asset ownership, including end-to-end information technology infrastructure and supporting technology innovation, and to invest in growth through additional engineering capacity.

Creating value

Our ability to provide a fully integrated, end-to-end service distinguishes us within the market.

For investors
Growing revenue and profits, enabling us to pay a progressive dividend while retaining funds to invest for future growth.

5.98p

Total dividend per share

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

3.1m

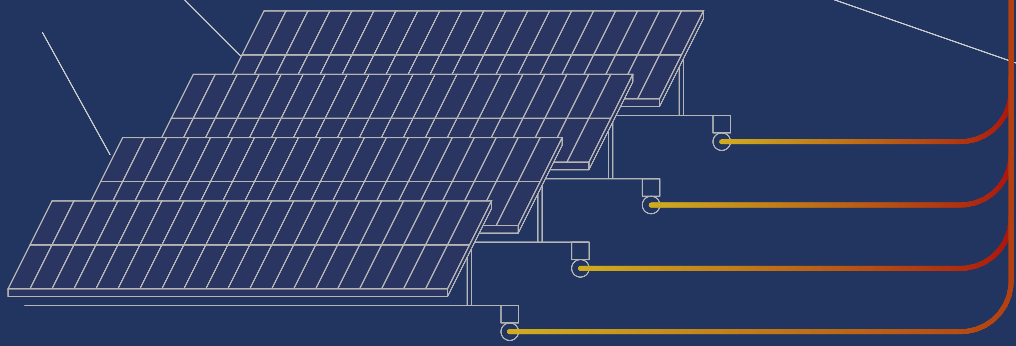
Managed meter and data assets

For employees
Interesting and challenging careers in a growing business that offers them the chance to develop and reach their potential.

964

Total employees

> **"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."**
>
> Alan Foy
> Chief Executive Officer



The smart energy revolution

The world's energy system is being transformed by the emergence of smart technologies. This disruptive, data-driven transformation is set to have a profound and lasting impact on both energy demand and supply, making it more connected, more reliable and – crucially – more sustainable. In tandem with modern technological breakthroughs and greater data availability, it is the pressing social, environmental and economic requirement to decarbonise our energy usage that has become the major driver for this energy upheaval.

As a result, it has today been internationally recognised – predominantly through the 2015 UN Paris Agreement and other supporting national carbon reduction frameworks – that a transition to a more inclusive, sustainable, affordable, and secure energy system is needed. This modern energy system – made possible by the convergence of new smart technologies and greater data availability – is one that can provide solutions to our universal energy-related challenges, at the same time creating added value for society without compromising the fundamental balance of energy security, environmental sustainability and economic growth.

Leading the smart energy revolution

We fulfil our mission to deliver the future of smart energy through our unique energy offering which serves an ever-increasing number of energy suppliers, industrial and commercial organisations, and the wider domestic market to realise the benefits of smarter energy practice. Through these services, we are playing an increasingly critical role in transforming and decarbonising the UK energy system.

This data-led transformation is creating new and innovative solutions to deliver cost savings and to meet carbon reduction goals. Consequently, we are now seeing the formation of a large market for the establishment and management of intelligent technology assets, smart sustainable systems, and energy efficiency services. We are uniquely positioned to be a continued driving force as this market grows, helping lead the smart energy revolution in the UK.

Smart meters: the cornerstone of the smart energy system

The development of a world-leading smart energy system delivering secure, cheap and clean energy is an important part of the UK Government's plans for its economic and industrial future. As highlighted by the government's Clean Growth Strategy – the ambitious proposal to decarbonise all sectors of the UK economy through the

SOLAR

SMS has been involved in the solar industry in the UK since the government first launched the Feed-in-Tariff (FiT) scheme in 2010. Since then we have worked closely with housing associations, installation contractors, energy suppliers and FiT administrators. Our services in this area have been to install smart meters to monitor and provide consumption data from the solar generation, to connect them to the electricity distribution network, and to register the MCS accredited schemes with the FiT supplier to enable and then manage the ongoing collection of generation and export revenue.

We are now expanding our services in this field to include managing the end-to-end installation and delivery of Photovoltaics (PV) and distributed generation solutions, based on our proven engineering knowledge, customer journey and IT field management platform and supported by our electricity connection, metering and data services. These installations will be complemented by the introduction of other technology, including smart meters. Smart meters not only measure and record export of generation to the grid, but can also be integrated with battery storage and demand side management solutions which maximise the benefit of local generation to the end consumer.

As of 2019, we provide services to a PV portfolio of around 10,000 sites with a combined installed capacity of c.20MW.

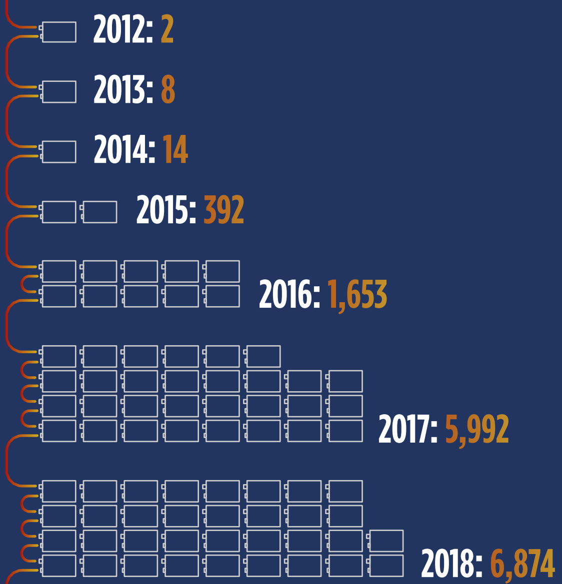
BATTERY STORAGE

Over 9,000MWh of battery energy storage is expected to be deployed in Britain over the next five years*. This high growth is driven by the need to better balance supply and demand, particularly with an increasing amount of intermittent renewable generation connected to the grid.

Utilising our national engineering capability and integrated with our delivery of smart metering solutions, SMS will be directly contributing to this market growth over the coming decade, and have begun testing and developing trial and proof of concept solutions with our I&C and energy supplier customer base.

* Source: UK Battery Storage: Opportunities & Market Entry Strategies for 2018-2022, Solar Media Market Research.

Applications submitted for UK battery storage projects (by MW, cumulative total) 2012-2018



Source: www.renewableuk.com: Energy storage capacity set to soar 300 UK based companies involved in new sector

2020s – smart technologies and services will play a vital role in decarbonisation, and the ongoing national smart meter rollout is fundamental to this mission.

At the cornerstone of the future smart energy system, smart meters are a vital upgrade to our national energy infrastructure, not only putting consumers in control of their energy use, but also providing the building blocks of a more flexible and resilient energy system. This could bring consumers, the energy industry and wider economy up to £40 billion[1] of benefits over the next few decades.

The future smart energy market

Smart metering and data services

Almost 15 million smart and advanced meters have so far been installed across homes and businesses in the UK. In total, 53 million smart meters need to be offered to UK premises as part of the domestic smart rollout by the end of 2020, representing a remaining market of 38 million smart meters left to potentially be installed. The non-domestic smart meter rollout (of which just over a million devices have been installed) also covers approximately two million sites. All these meter points provide opportunities for data services for the purposes of settlement, analytics, presentation and additional energy service and asset opportunities.

As at 31 December 2018, our portfolio of metering and data assets under management stands at 3.1 million (up 54% from 2017). A significant part of this growth has been due to the continued expansion of our customer pipeline in the mandated smart domestic meter rollout, where we now own more than 846,000 smart meters. Looking forward, our current contracted customer pipeline through our exclusive and framework agreements gives us access to a further c.8 million meter points to be exchanged to smart.

1 BEIS smart meters unlocking the future

EV CHARGING

Electric vehicle (EV) charging represents a huge opportunity for the UK's Industrial and Commercial sector. It is estimated that there will be 35 million electric vehicles on UK roads by 2040[1], with 3 million public-use charge points required alongside domestic charging points to enable the mass rollout of green fleets[2].

In the shorter term, the UK will need more than 80,000 extra charge points in the next two years to cater for the 1 million EVs in use by 2020[3] (currently there are only 19,000 points in the UK[4]).

Through our OLEV approved electric vehicle (EV) installation charging solutions, we are supporting the UK market to establish this national network of EV charging infrastructure. For example, we are project partners on a Park & Charge project, which aims to demonstrate a fully integrated, scalable EV charging network for on-street residential parking.

35 million

estimated electric vehicles on UK roads by 2040[1]

1 National Grid Future Energy Scenarios 2018.
2 Aurora Energy Research.
3 Emu Analytics.
4 ZapMap.

BIG DATA

Smart meters provide huge amounts of data, which enables consumers and energy suppliers to control and reduce the generation, use and storage of energy. This data-driven requirement is creating opportunities for innovation for organisations inside and outside the energy sector, enabling growing technologies and services such as electric vehicles, smart tariffs and microgeneration to be efficiently integrated with renewable energy generation; lowering emissions; and cutting costs for consumers.

At SMS we not only deploy the devices that produce the data essential for managing and understanding energy flows, we use this data across our range of services to help our customers make better decisions. We do not just create data, we seek it out and we use it to solve problems and provide opportunities for achieving operational efficiency and sustainability – for example through provision of data analytics, presentation and settlement services which drive the control of energy usage and generation.

Data is at the centre of the smart energy revolution, and it is at the centre of everything we do at SMS.

> **"Data is at the centre of the smart energy revolution, and it is at the centre of everything we do at SMS."**

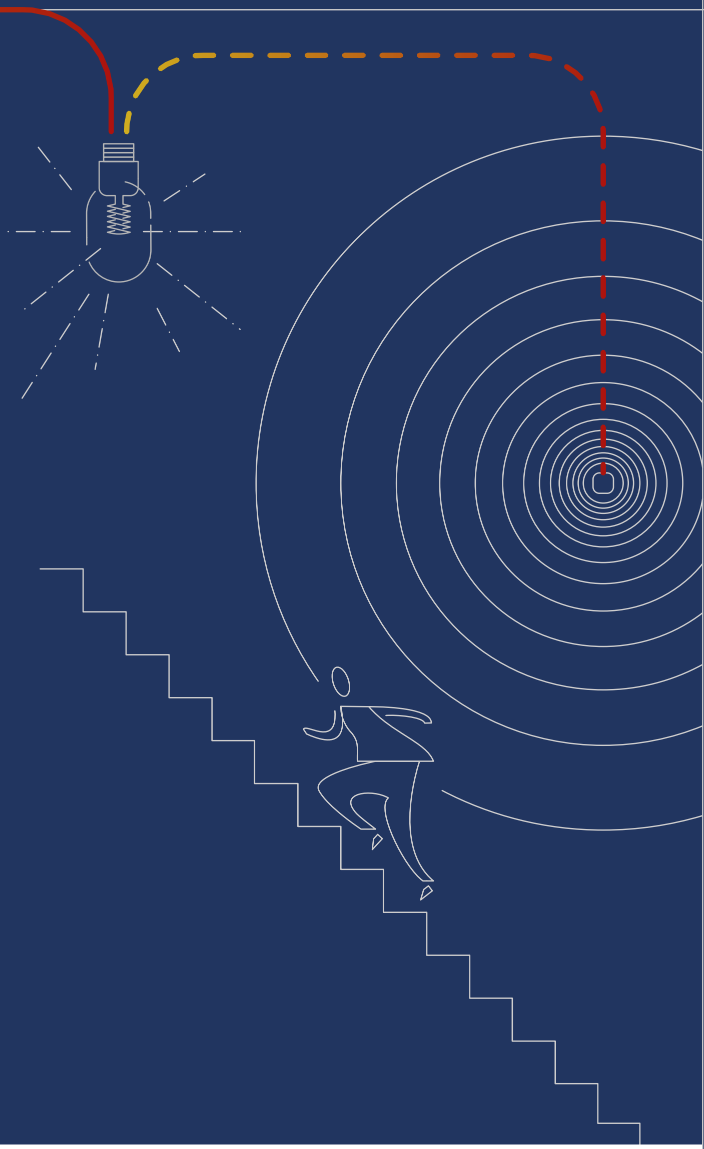
LED LIGHTING

Our energy services division not only identifies and recommends energy-saving solutions, but also then works with I&C customers to deliver the resultant energy-efficient and carbon reduction measures.

For example, SMS is currently working in conjunction with a large national UK hotel chain to install LED lighting and movement sensors in all staff and communal areas throughout the hotel's estate.

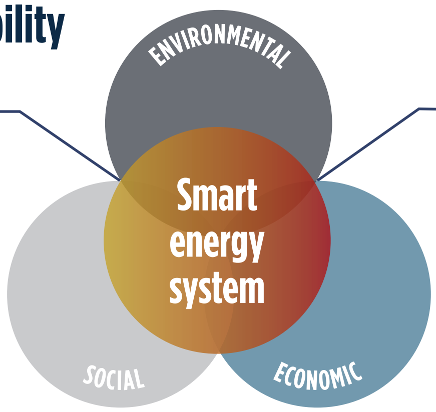
This opportunity arose due to our identification of energy-efficient recommendations under the government's Energy Savings Opportunities Scheme (ESOS), which included an LED retrofit trial. In March 2018, full-scale rollout commenced and to date 166 installations have been completed out of 460 potential sites identified.

The project is expected to deliver annual savings of over 4,000 tonnes of CO_2e p.a. and reduce the customer's energy bill by over £2m p.a. Due to be complete in Q2 2020, the success of the project is now leading to other opportunities for capital projects to deliver further energy and carbon savings across our customer's estate.



Smart energy and sustainability

- Smart meters, and the data they produce, are the cornerstone of the smart energy system.
- Smart meters, renewable energy, clean transport, automation and IOT, energy storage, connected devices, smart tariffs, demand response, smart energy tech and energy efficiency.



£40bn[1]

The smart energy system has potential to save the UK £40bn by 2050

Economic	Environmental	Social
▶ Efficiency and profitability ▶ Cost savings ▶ GDP growth ▶ Innovation and technology ▶ CSR	▶ Decarbonisation ▶ Reduced climate change and air pollution ▶ Conservation and preservation ▶ A greener, healthier planet	▶ Conscious consumers ▶ Democratisation of energy ▶ Energy prosumers ▶ Interconnectivity and community ▶ Higher quality of life ▶ More ethical society

1 BEIS smart meters unlocking the future.

Our services

As an Ofgem-approved meter installer, our experienced and friendly workforce installs meters throughout the UK. Our best-in-class services allow us to play a critical role in transforming and decarbonising the UK's energy networks. We also provide and manage multi-utility infrastructure solutions. Our services cover the entire connections process from the initial feasibility stages and procurement to the final installation works, ranging from one-off gas and electricity connections, to multi-utility major projects.

Review of the year

Health and safety continues to be at the forefront of our priorities within asset installation and we have continued to increase our investment in this area during 2018. We have looked to increase quality and volume in house, through our training academy, which has undergone a series of investments. We have also continued to invest in new technologies and people, to underpin one of our key values and commitment to "safety".

2018, operationally, has been primarily focused on increasing our smart metering installation capacity, which has been aimed at meeting the increased installation needs of our asset management division, for the UK smart meter rollout programme. We have leveraged our in-house installation capability to deliver meter assets effectively and on time and have strived to increase the efficiency of our engineering workforce through more effective planning, scheduling and training.

Whilst the transition to the delivery of SMETS2 meters has brought short-term technology, logistical and operational challenges, we have remained focused on carefully managing capacity and installation run rates. In this way, we have demonstrated to our customers that we can remain flexible and responsive to changes in the market, always providing the highest quality installation service.

We will continue to improve our service, to promote a fantastic experience for our customers and, in turn, their customers. We seek to become an extension of their business, rather than an outsource partner. We want to ensure we exceed our customer expectations at all times.

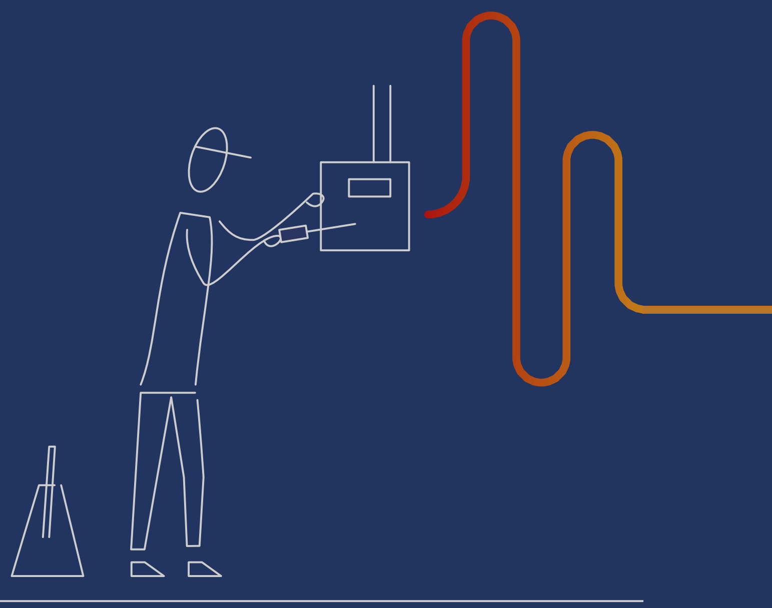
£26.6m

Revenue

£6.1m

Gross profit

Asset installation



Business model

Our in-house operational delivery model is centred around a number of critical activities:

- Technical assurance – training, development and competent management of all our engineering workforce.
- Customer service – ensuring we have a dedicated customer-facing team, which is responsible for customer experience, account management and ensuring we always fulfil our service ethos.
- Customer contact – innovation in customer appointment booking and management to ensure we maximise delivery opportunities across customer portfolios.
- Scheduling – whilst driving efficiency, ensuring we always deliver on customer appointments.
- Engineering management – day-to-day, first-class delivery through our trained and accredited workforce.
- Integrated IT platforms – enabling us to integrate our services with our customers and provide an excellent customer experience.
- Supply chain and logistics management – ensuring the right stock is in the right place at the right time.

This model allows us to control all aspects of operational delivery, working in partnership with our customers and being able to tailor our services to specific customer requirements. This national and large-scale engineering capability, as well as being able to deliver the smart meter rollout, also works to provide supporting maintenance and emergency services and, potentially in the future, installation of new asset classes partly enabled by the UK's smart metering rollout.

Looking ahead

Besides smart meters, our smart energy future depends on the wider establishment of national green energy infrastructure, namely renewable energy generation, energy storage systems, and a countrywide network of public and private electric vehicle charge points. We are currently developing our capacity to play a leading role in expanding the national electric vehicle (EV) charging network and deployment of microgeneration through a specialist electricity connections, asset installation and asset finance service.

Asset installation's primary objectives are:

1.

Safely deliver assets which provide long-term recurring revenue to our business.

2.

Serve our customers to deliver their on-site metering requirements, remembering that we are the energy suppliers' representative and that our success is built on customer service.

The key to both these objectives is a safe, customer-focused, trained, efficient and growing workforce.

Our services

Through our end-to-end metering and data solutions, we manage over 3.1 million metering and data assets on behalf of a continually expanding customer base of energy suppliers from the I&C market and domestic smart meter rollout. We also provide independent Gas Meter Asset Management (MAM), Electricity Meter Operator (MOP) and Data Collection Data Aggregation (DCDA) services directly to business end users, both in the I&C and public sectors.

Review of the year

2018 has continued to be a year of growth for the asset management division as we have invested effectively to position ourselves as a market leader in the UK smart meter rollout.

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.

Whilst we have seen a slight slowdown in the installation of smart meters in the latter part of the year, attributable to the delayed transition to SMETS2 meters, we are confident that 2019 holds significant further opportunity within the market and we are ready to deliver.

We were delighted to continue our relationship with Shell Energy, through a new exclusive agreement, providing us with access to up to 1 million meter points as Shell Energy's fully integrated domestic smart meter installer and meter asset provider.

£65.5m
Revenue

£39.7m
Gross profit

Asset management

Business model

The asset management division is responsible for all meter and data assets from their initial deployment on the wall and for all electricity and gas industry agent appointments and related accreditations. As such we are responsible for tracking and management of our assets throughout their life, managing capital deployment and ensuring we realise the benefits of the significant investments we are making on behalf of our customers. Asset tracking and management reporting are therefore critical to our business to ensure we know where all our assets are and who is responsible for payment of rental charges at all times.

Our operational model is centred on a number of critical activities:

- Client and contractual relationships – ensuring that the businesses' commercial interests are protected.
- Asset tracking and management – financial and operational reporting, tracking and billing of all our asset base.
- Industry accreditations – ensuring compliance with industry bodies including MAMCoP and Elexon for our accredited industry services, a key enabler of our service provision.
- Data retrieval – collection of consumption information from all our data assets and provision of this information to our customers for billing and energy management purposes.
- IT systems – automate and enable this activity across our large and growing asset base, ensuring performance, resilience and capacity for growth and security of data.

This model ensures we are in control of the significant capital we are deploying and are able to ensure we realise the benefits of these investments over the life of our assets.

Looking ahead

Aside from providing more accurate energy billing (removing manual meter reading) and enabling consumers to better understand their energy usage, smart meter technology is a key component in the realisation of the smart energy grid – the digital, interconnected national network that will provide us with a more modern, more efficient and cleaner supply of power. Put simply, the smart grid will utilise a range of new technologies – with smart meters at the very centre of this chain – to allow for two-way communication between consumers and the energy network, enabling real-time, automatic responses to changing demand. Through our work to support UK government and energy suppliers in rolling out smart metering technology to the British public and SMEs, as well as providing MOP, MAM and data services directly to the Industrial and Commercial sector, SMS is playing a pivotal role in helping make the smart grid become a reality.

Asset management's primary objectives are:

1.

Manage all assets through their life, controlling capital deployment and return on investment.

2.

Grow our data and accredited industry settlement services to provide further recurring revenue opportunities.

The key to these objectives is a robust IT system to track our assets and deliver our accredited obligations, whilst maintaining strong commercial relationships with all our customers.

Our services

We specialise in large, complex multi-site portfolios and help businesses better understand energy usage, reduction and costs, and improve energy efficiency. We offer a full range of energy consultancy services including bill investigation, legislative advice and environmental management services. Our energy consultants advise on and implement effective long-term environmental strategies that reduce both energy costs and consumption. Our innovative approach to monitoring and managing consumption data allows us to extract additional value for our customers.

Review of the year

Our energy management division continues to be the hub out of which we deliver integrated and innovative energy solutions to our customers, working together to help realise a greener and more sustainable world.

The delivery of the smart energy revolution will require energy infrastructure and data-driven services, using technology, knowledge and engineering capacity. Through our energy management division we are uniquely positioned to help achieve this.

In 2018 we continued to see increased demand for our energy, utility infrastructure and connections services and are delighted to have engaged a major national hotel chain as a significant customer for the design and installation of energy-efficient LED lighting into 490 of their hotels.

£6.5m
Revenue

£1.4m
Gross profit

Energy management

Business model

The energy management division is responsible for ensuring customers realise the benefit of consumption data and to enable them to reduce their energy spend and carbon footprints. We are a specialist partner for managing energy and we do this by addressing all of the drivers that underpin the energy budget – taking a holistic, data-driven, systems-based approach, but delivering a range of specific services to maximise energy saving.

Our operational model is centred on a number of critical activities:

- Utility bureau and bill validation – controlling and managing energy spend to ensure billing discrepancies are identified and resolved and ensuring high quality visibility of energy spend and budgetary information.
- Risk management and procurement – our energy procurement team provides expert advice and market knowledge to deliver the best priced energy. We are one of the UK's leading energy consultants to manage the risk and procurement process, securing our clients the best value energy supply contracts. Our continued success is due to our ability to work impartially with UK energy suppliers whilst delivering our unrivalled customer service.
- Energy reduction and environmental management – we provide practical guidance and support to reduce carbon footprint and maximise energy efficiency. Our data-driven strategies set clear and realistic objectives for efficient energy usage. Our strategies are based on energy assessment surveys and made possible by our bespoke energy data platform. With the right data at our disposal we target areas for improvement and set parameters for usage and deliver turnkey projects to reduce energy consumption.

This model ensures we are able to deliver tangible savings to our customers, underpinned by our data collection and analytics capability, and to also provide recurring revenue opportunities for our metering and data collection services.

Looking ahead

The greater convergence and availability of consumption data is having a profound effect on our relationship with energy. While the benefits of a more intelligent energy system are universal, for large energy consumers (i.e. organisations) the potential advantages of the smart energy revolution are multiplied. Energy consumption, after all, is inextricably linked with profitability. This explains the huge rise in demand for energy efficiency and data services in recent years as companies call for improved insight into their energy use. Going forward, such demand is expected to develop further still as an increasing amount of businesses consider their sustainability (both from an environmental and financial perspective), while simultaneously facing the heightened pressures of rising energy costs and brand new compliance regulations.

Energy management's primary objectives are:

1.

Enable end customers to reduce their energy consumption, carbon footprints and energy costs through a data-driven approach.

2.

Develop long-term customer relationships facilitating our full range of energy and data services.

3.

Extend our services to support investment in wider asset classes, such as energy efficiency, generation, storage and electric vehicle infrastructure initially in the I&C market but also across the Domestic segment.

The key to these objectives is the development of skilled, expert and knowledgeable staff, aligned to our vision to deliver the transformation and decarbonisation of the UK energy system.

Continued momentum

Highlights

- Revenues increased by 24% from £79.6m to £98.5m
- Annualised recurring revenue increased by 32% from £57.0m to £75.3m
- Pre-exceptional EBITDA[1] increased by 28% from £40.3m to £51.6m, with statutory EBITDA decreasing slightly to £35.5m.
- Underlying PBT[2] increased by 13% to £25.1m, with statutory PBT decreasing from £18.0m to £5.4m after charging £17.1m of exceptional items
- Capital investment in meters of £128.2m (2017: £122.5m)
- New revolving credit facility agreed with access to £420m over the next five years

1 Pre-exceptional EBITDA includes other operating income.

2 Underlying PBT is before exceptional items and intangible amortisation.

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 forward 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.

Exceptional items continued

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.

David Thompson
Chief Financial Officer
4 April 2019

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	

Our people and sustainability

Our vision

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

Our mission

To deliver the future of smart energy.

People management and development

SMS has c.1,000 employees nationwide, united by our established culture and heritage. We place great importance in creating a positive working environment for all of our employees. This tone is set from the top by our Executive Directors and is encouraged downwards throughout the organisation. At SMS we lead by example and believe better leaders develop better employees; therefore, in 2018 we commenced a professional executive coaching programme to enhance the key skill sets of our management teams.

We believe that satisfied employees encourage creativity, productivity and cost efficiencies within our organisation, which is key to allowing us to execute our strategy and achieve our mission. Throughout 2018 we made significant headway in aligning and improving our employee rewards and benefits across the Group. We are delighted to announce that we reached a milestone of becoming a "Living Wage Employer" and are proud to confirm the advancements we are making in striving to become an "Employer of Choice".

Learning and development has become a heightened area of focus. Investment in our employees has a direct and positive impact on our employee retention rates and engagement levels. Currently, each part of the business has tailored training programmes in place to provide new employees with the necessary skills to execute their role effectively.

In preparation for the implementation of GDPR, the Group devoted significant resource to preparing and rolling out high quality GDPR training throughout the year, which focused on heightening awareness on the interrelated issues of data governance, cyber security and business continuity. It was of crucial importance to us that all employees were sufficiently trained in GDPR compliance in order to play our part in protecting the fundamental rights and freedoms of individuals.

At SMS our engineer training is second to none. Our in-house, fully accredited academy delivers world-class training and is the first dedicated smart metering training facility in the UK. This means that we have the ability to recruit and train our own workforce. With continued investment and refurbishments taking place throughout 2018, we are increasing our installation capacity and capability as we continue with the smart meter rollout and beyond. In 2018, we delivered over 30,000 hours of engineer training and we also launched a new eLearning platform for our engineers.

A significant amount of progress has been made with our journey to standardise our processes across the Group wherever possible and to develop and utilise technology to consolidate our information systems. This nationwide incentive will continue to make significant headway throughout the coming year.

Health and safety

Protecting the health and safety of our people, customers, suppliers and members of the public is a core priority for us and we are pleased to report there have been no significant health and safety incidents in the year.

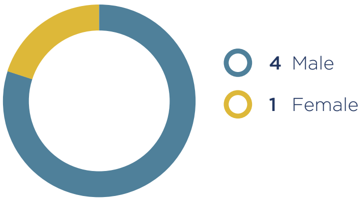
During 2018 we increased the involvement of our Executive Directors with specific health and safety accountabilities being assigned to certain Board members. The Board is committed to ensuring that the necessary organisation exists and resources are available to facilitate the achievement of our health and safety goals, which are monitored on a monthly basis.

Our Executive Directors are supported by the Head of Group SHE (Safety, Health and Environmental) team whose responsibility is to ensure that the health and safety policy, standards and procedures are effective and implemented throughout SMS. We employ a rigorous approach to risk management in order to avoid incidents which could bring harm to the public or our people and damage to Company property or reputation. Through the organisation's risk management process, we have identified key health and safety risk factors and have put mitigating actions in place.

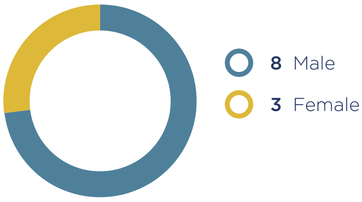
In 2018, the SHE team introduced a Technical Executive Committee. This Committee meets monthly and is responsible for improving governance, monitoring and controlling significant safety risks and improving the harmonisation of policies and procedures across the Group. The SHE team was also restructured and strengthened, with two additional regional SHE advisers being appointed along with a SHE administrator. We also invested in a new Electronic Safety Management System, which will be the cornerstone of our risk management processes.

Gender breakdown

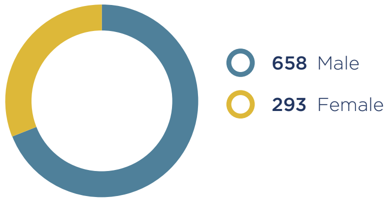
Board of Directors



Senior management



Other employees



Corporate social responsibility

Corporate social responsibility is an integral element of our business model and critical to our commitment to managing risk in all areas of the Company. We aim to effectively deliver solutions to our customers while also caring for the environment on which we all depend.

Our solutions enable us to have a significant overall positive environmental impact by influencing both our supply chain and customers in the energy and utility choices they make. We strive to achieve the sustainability goal of affordable and clean energy through a low-carbon smart energy revolution, which SMS are helping enable through various outlets.

When appointing an outsourced contractor to deliver any works on our behalf, environmental considerations are agreed as part of our contract specifications and competencies are assessed prior to acceptance onto the SMS contractor supply database.

We also carefully manage our own operational environmental impact through robust internal energy and environmental management systems. In 2018 we launched our EnviroMatters campaign, an initiative designed to encourage employees to think and act more sustainably both inside and outside of work. As part of the scheme a number of “Green Heroes” have been appointed across the organisation to help drive this initiative.

Diversity and human rights

The Group places considerable value on the involvement of its employees and continues to keep them informed of matters affecting them and the performance of the business. This is achieved through regular communications, employee newsletters, briefings and meetings. In 2018, SMS launched an internal intranet site which acts as an information hub for Company news and information.

We promote a corporate culture that is based on ethical values and behaviours. Various indicators are used to monitor and provide insight into the Group’s culture, including employee engagement, health, safety and wellbeing measures and diversity indicators. The state of the Group’s culture is assessed through compliance reviews, internal audit and formal and informal channels for employees to speak up.

SMS is an equal opportunities employer and our employees and applicants are treated fairly and equally regardless of their age, colour, creed, disability, full or part-time status, gender, marital status, national or ethnic origin, race, religion or sexual orientation. Our commitment to diversity means creating a working environment that is respectful and engaging and we firmly believe that diversity helps to enhance productivity and innovation.

We have an anti-corruption policy in place which relates to compliance with the Bribery Act 2010. We also provide a confidential whistleblower service. The outcome of any report or incident investigation is summarised and provided to the Audit Committee for its review.

We continue to monitor the impact of our work in the area of modern slavery, in line with the UK Modern Slavery Act 2015, ensuring we have in place the most effective responses to any potential risk.

We believe in the preservation of human rights and recognise both their importance and our obligation to protect them. To support this commitment, we have policies covering key areas such as grievances, harassment and bullying at work, equal opportunities and dignity and professional conduct and behaviour, to ensure that all our employees, customers, suppliers and their stakeholders are treated fairly and with respect. We also monitor our gender pay gap and published results can be found on our website.

We employed on average 915 people in the UK during the year. As at the financial year-end date of 31 December 2018 the Group employed 964 people, excluding three Non-executive Directors.

Craig McGinn
Company Secretary and General Counsel
4 April 2019

Risk governance

As operations continue to expand in line with our ambitious growth plans, our approach to risk management has continued to evolve and adapt. We provide services in a range of potentially high-risk environments and our commitment to effective risk management continues to be a primary focus.

The Board is responsible for setting the tone at the top and the monitoring of business performance includes a regular review of risks that could impact on delivering the strategy and achieving our organisational objectives. The Board is supported by an effective governance structure that includes an Audit Committee which continuously reviews the effectiveness of the Group's systems for internal control, financial reporting and risk management processes.

The Group Internal Audit function has worked closely with executive management and the Audit Committee throughout 2018 to ensure that robust risk management processes are further embedded at all levels of the business. Key successes in 2018:

- introduction of a Technical Assurance Committee to streamline cross-functional risk and audit activity;
- investment in an improved quality management system for centrally tracking and co-ordinating Group compliance, safety, health and environment, internal audit and risk management activities;
- development of an integrated assurance framework to present a holistic view of assurance activities to the Board, Audit Committee and executive management; and
- improved risk reporting to the Board and Audit Committee.

Understanding our risks

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

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

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

- the extent of inherent risk (i.e. before any mitigating controls or actions); and
- the extent of residual risk (i.e. after mitigating controls and actions).

This allows us to assess the effectiveness of our control environment and take further action as appropriate.

We continually evaluate our principal risks in line with our strategic priorities and the prevailing industry and market conditions. In 2018 we have further developed our risk framework, including improved reporting to the Board, and we have adjusted the way that we define, capture and manage risk. As a result, we have included a number of new risks in 2018 as part of our principal risks and uncertainties.

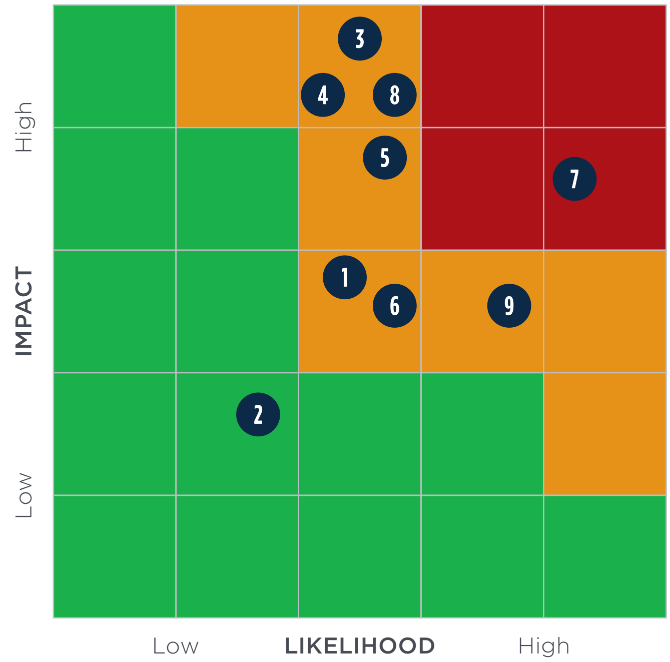
> **"The Board is responsible for setting the tone at the top and the monitoring of business performance."**

Risk management

Our principal risks are presented opposite on a heat map showing the potential impact and likelihood of crystallisation. These are assigned a red, amber or green status depending on the perceived overall severity. Risks that fall into one of these categories are treated as follows:

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

All risks are assigned mitigating actions with an appropriate business owner and are supported by an executive sponsor to ensure there is a robust process for continuous improvement.



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

Our principal risks and uncertainties

Set out below are the principal risks and uncertainties which could have a material impact on the Group. The numbers correspond to the risks identified on the heat map. These risks are continually monitored. We indicate whether or not the probability or impact of the risks materialising has increased, decreased or remained unchanged and set out the corresponding mitigating actions that have been taken by the Group.

Risk increased No change Risk decreased

1. Business continuity — failure of critical business system(s)

FY17: No change | FY18: No change

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

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

Existing mitigating controls
- Disaster recovery plans in place for critical IT systems
- Failover facility available for immediate redeployment of staff, enabling key operations to be serviced
- Alternative UK sites available to manage core business operations

2. Funding and working capital management

FY17: Risk decreased | FY18: Risk decreased

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

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

Existing mitigating controls
- Credit control facility and robust commercial billing arrangements
- Regular and formal review of key management information in relation to cash and debt positions
- Recently renegotiated revolving credit facility extending £420 million to 2023

3. Major health and safety incident

FY17: No change | FY18: Risk decreased

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

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

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

Risk increased No change Risk decreased

4. Speed of organisational growth (near term) — New risk for FY18

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

Potential impact
- Insufficient engineering capacity/resource available
- Limitations on organisational back-office and support functions
- IT infrastructure and scalability
- Metering supply and warehousing operations

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

5. Critical supplier dependency — FY17 FY18

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

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

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

6. Potential breach of General Data Protection Regulation (GDPR) — New risk for FY18

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

Potential impact
- Financial penalties under the General Data Protection Regulation GDPR
- External investigation(s) by the Information Commissioner's Office
- Loss of customer and/or supplier confidence

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

7. Potential breach of cyber security — New risk for FY18

Detailed risk
Information technology systems could be subject to external or internal cyber attacks, causing a breach of information security regulations.

Potential impact
- Financial penalties under information security regulations
- Service disruption
- Loss of customer and/or supplier confidence
- Loss of accreditations and certifications

Existing mitigating controls
- Formal cyber security policy, including phishing response procedure, communicated to all SMS staff
- Mandatory security awareness training for all SMS staff
- Physical controls in place including firewalls and encryption
- Appointment of Head of Information Security and dedicated information security team
- An independent Information and Technology Committee

Risk increased No change Risk decreased

Our principal risks and uncertainties continued

8. Loss of required accreditations

FY17 FY18

Detailed risk

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

Potential impact

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

Existing mitigating controls

- The Board has overall accountability for compliance with safety, health and environmental standards and is provided with regular management reporting
- Well-established Group Technical Assurance team including an experienced Compliance function with deep industry insight and expertise
- Dedicated training academy for field service engineers
- Rolling training plan in place for all engineering staff to maintain and upgrade certifications
- Extensive internal audit activity across Group and Technical Assurance
- Regular external independent and routine audits from regulators
- Effective HR on-boarding process for new staff including engineering team

9. Brexit

New risk for FY18

Detailed risk

SMS could be impacted by the UK's current commitment to leave the European Union in 2019:

- People – the implication of Brexit for EU citizens, who form part of the Group's workforce, is unclear
- Supply chain – contractual arrangements currently in place could be adversely impacted
- Funding – mounting pressure on the British Pound could lead to negative funding implications for the Group

Potential impact

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

Existing mitigating controls

- The Group continues to monitor and assess the impact of various scenarios in relation to Brexit
- SMS has conducted analysis over the number of EU employees within its business and considers the potential impact to be minimal
- We have performed a partner review with our critical suppliers which source supplies from outside the UK to ensure there are robust continuity arrangements in place in the event of adverse changes to trade arrangements including a "no-deal" Brexit
- We have sufficient coverage in our supply chain and inventory arrangements to withstand significant delays and honour any outstanding customer commitments
- Recently extended revolving credit facility agreed with banking consortium
- Continual review of hedging arrangements

The Strategic report is approved by the Board of Directors on 4 April 2019 and signed on its behalf below.

By order of the Board

David Thompson
Chief Financial Officer
4 April 2019

Creating long-term success

Dear Shareholder,

I am pleased to present our Corporate Governance Report.

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

Changes to the corporate governance regime

As an AIM-listed company, the Company is required to provide details of a recognised corporate governance code that the Board of Directors has decided to apply and explain how the Company complies with that code, and where it departs from its chosen corporate governance code provide an explanation of the reasons for doing so.

In considering its own arrangements for governance, the Company adopted the provisions of the Quoted Companies Alliance's Corporate Governance Code (the QCA Code), published in April 2018. The key elements of the Company's corporate governance arrangements are described in this report.

I am delighted to confirm that we comply with all the principles of the QCA Code, as well as elements of the UK Corporate Governance Code, published in July 2018. We will continue to adopt further elements of the UK Corporate Governance Code as appropriate.

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

Our core values of investing in our people, systems and capacity remain as important to us today as they have been over the last 23 years. A culture of strong corporate governance is an essential element of that.

There was one change to the Board during the financial year, with Kelly Olsen joining the Board on 24 January 2018. Kelly resigned as a Non-executive Director of the Company on 17 October 2018, in order to allow her to concentrate on a new external, full-time position. The Board extends its thanks to Kelly for her dedication and contribution to the Company during her short time with it.

Further details of the Board's composition are given on pages 36 and 37.

Willie MacDiarmid
Non-executive Chairman
4 April 2019

23 years
of continuous focus on our core values

Board of Directors

Willie MacDiarmid

A N R

Non-executive Chairman

Date of appointment
14 April 2014, Chairman 26 May 2016

Background and experience
Willie is a very experienced non-executive and executive director having held a number of senior posts across various sectors. Amongst a number of previous senior positions, he was formerly interim CEO at Barchester Healthcare, CEO of May Gurney, a main board director at Eaga PLC and on the executive board of ScottishPower for ten years. ScottishPower's successful metering business was part of his portfolio. Willie also acts as an independent consultant for a number of companies.

External appointments
Willie is currently chairman of Fallago Rig, a joint venture between Hermes Capital and EDF Renewables, and chairman of Ogilvie Group, a Stirling-based family owned business with interests spanning construction, fleet hire and IT. He was formerly a non-executive director at Grove, the holding company for Barchester Healthcare and Business Stream (Retail Water and Waste). Willie also works with senior executives across various industries mentoring and providing one-to-one coaching.

Alan Foy

N

Chief Executive Officer

Date of appointment
24 December 2007

Background and experience
Alan has been Chief Executive Officer of SMS since 2007. He led the flotation of the Company on the London Stock Exchange AIM in July 2011. In the past six years, annual turnover and profits have risen significantly through a combination of strategic acquisitions and organic growth. Prior to joining SMS in 2004, Alan worked for ScottishPower and, in 1997, gained approval to establish its regulated gas transportation and metering business, SP Gas Ltd, which under his management grew to become a major gas transporter in the UK.

External appointments
Alan was previously a director of an international energy consultancy practice and has considerable experience in utility asset ownership, supply and shipping activities. A professionally qualified engineer, Alan places strong emphasis on team development, safety, operational performance and financial accountability within an ethos of customer satisfaction.

David Thompson

Chief Financial Officer

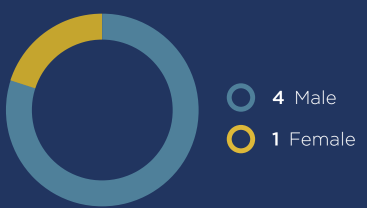
Date of appointment
11 September 2017

Background and experience
David operated at both divisional and Group Finance Director level within SMS prior to appointment as Chief Financial Officer. David has held senior finance roles at Energetics Multi-Utility Group, a company owned by Macquarie Bank, and before that he held audit director posts at PwC LLP and Johnston Carmichael LLP.

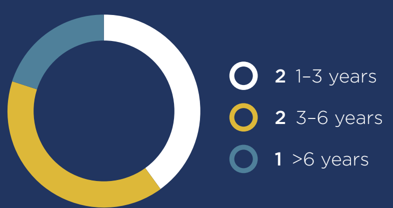
External appointments
None.

Diversity, independence and experience

Gender



Tenure



Miriam Greenwood
A N R
Senior independent Non-executive Director

Date of appointment
3 February 2014

Background and experience
With qualifications as a barrister and in corporate finance, Miriam has spent more than 30 years working for a number of leading investment banks and other financial institutions. She was, for nine years until 2013, a non-executive director of the Gas and Electricity Markets Authority (Ofgem). A Deputy Lieutenant of the City of Edinburgh, Miriam was awarded an OBE for services to corporate finance in 2000.

External appointments
Miriam is a founding partner in SPARK Advisory Partners, an independent corporate advisory business, and a non-executive director of Eclipse Shipping Limited. During 2018, she was appointed as adviser to the Mayor of London's Energy Efficiency Fund and to the Gas and Electricity Markets Authority (Ofgem). Miriam was also formerly a non-executive director at Mithras Investment Trust plc and Telit Communications plc.

Graeme Bissett
A N R
Independent Non-executive Director

Date of appointment
1 June 2016

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

External appointments
He currently holds non-executive appointments with Cruden Group Limited, Anderson Strathern LLP and Aberforth Split Level Income Trust plc and undertakes a number of pro bono appointments, including as a member of Court at the University of Glasgow and trustee of Citizens Advice Scotland.

Craig McGinn
Group Company Secretary and General Counsel for the Group

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

Key to Committees
- A Audit
- N Nomination
- R Remuneration
- Chair

Board composition

- 2 Executive Directors
- 3 Independent Non-Executive Directors

Sector experience

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

Corporate governance report

The Board

Board structure

The Company is led by a strong and experienced Board of Directors (the Board) which brings a depth and diversity of expertise to the leadership of the Company. The Board has an appropriate balance of skills, experience and knowledge of the Group to enable it to discharge its responsibilities effectively. The Board currently has five members, comprising two Executive Directors, the Non-executive Chairman and two independent Non-executive Directors. The Board has a breadth of experience across the utility sector, engineering, finance, legal and corporate finance which are essential elements required to support the delivery of the Group's strategy over the medium to long term.

The Board currently comprises:

- the Chairman, Willie MacDiarmid;
- the Chief Executive Officer, Alan Foy;
- the Chief Financial Officer, David Thompson; and
- Non-executive Directors, Miriam Greenwood and Graeme Bissett.

The details of each Director are set out in the Board of Directors section of this report.

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

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

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

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

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

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

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

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

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

Role of the Board

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

There is a formal schedule of matters reserved for the Board, including approval of the Group's annual budget, the Group's strategy, acquisitions, disposals and capital expenditure or

The Board of Directors

The Board delegates certain matters to its three principal Committees, which deal with audit, remuneration and nomination.

The Group Company Secretary also acts as Secretary to each of the Committees.

Audit Committee	Remuneration Committee	Nomination Committee
Has oversight of the Group's internal control and risk management, and monitors and reviews the integrity of the Group's financial statements and the relationship with the external auditor.	Determines the remuneration for Executive Directors and oversees the Group's overall remuneration policy, strategy and implementation.	Monitors and reviews the composition and balance of the Board and the Committees to ensure SMS has the right structure, skills and experience in place for the effective management of the Group.
▶ Graeme Bissett (Chair) ▶ Miriam Greenwood ▶ Willie MacDiarmid	▶ Miriam Greenwood (Chair) ▶ Graeme Bissett ▶ Willie MacDiarmid	▶ Willie MacDiarmid (Chair) ▶ Alan Foy ▶ Miriam Greenwood ▶ Graeme Bissett

investment projects above certain thresholds, approval of the Annual Report, approval of any reports or information to be issued to shareholders of the Company, approval of the Company's share dealing policy, the appointment of the Company's independent auditor, the Company's dividend policy, borrowing powers, approval of any material changes to the Company's accounting policies or insurance policies, remuneration of Directors, Executive officers and senior employees, alterations to the constitutional documents of the Company, the adoption of any new, or amendments to, major employee benefit plans, legal actions brought by or against the Group above certain thresholds, authorisation of political and charitable donations and the scope of delegations and appointments to Board Committees and subsidiary Boards. Responsibility for the development of policy and strategy and operational management is delegated to the Executive Directors and senior management team.

Board evaluation

The Company has implemented a formal process of annual performance evaluation for the Board, its Committees and individual Directors. The year to 31 December 2018 is the third year of this process. This process gives the Directors the opportunity to identify areas for improvement both jointly and individually through the use of questionnaires, one-to-one sessions with the Chairman and open discussion.

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

The evaluation process was run internally and commenced with the completion of a questionnaire containing a number of multiple choice and free text questions. The evaluation covered a wide spectrum of aspects affecting the Board including the composition and size of the Board (including succession), the appropriate range of skills, Board members' views on the strategic focus of the Board, the quality of Board materials and the frequency of meetings. A summary of the results was then compiled, and feedback obtained, and a discussion between the participants is facilitated.

The subsequent Board discussion highlighted certain areas including ensuring that the Board is focused on strategic matters, that sufficient time is available for discussion on important matters and other practical issues for consideration. The Board is committed to acting on the results of the evaluation and taking the appropriate action where any development needs have been identified.

The intention is that a performance evaluation of the Board, the Board Committees and individual Directors will be conducted annually and the method for such review will continue to be reviewed by the Board annually in order to optimise the process.

Succession planning is a matter reserved for the Executive Directors and the Non-executive Directors. A paper covering the subject is produced and reviewed by both the Nomination and Remuneration Committees when carrying out succession planning. The Board's policy is for the Board to have a broad range of skills, background and experience.

Independent advice

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

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

Board meetings and attendance

Board meetings are scheduled to be held eight times each year. Between these meetings, as required, additional Board meetings and Board Committee meetings may be held to progress the Company's business. A part of each Board meeting is dedicated to the discussion of specific strategy matters. Any conflicts of interest are declared at the start of each Board meeting and appropriate action is taken where necessary to ensure independent judgement is not overridden. Half of the Board, excluding the Chairman, are considered independent, which helps to address any conflicts of interest that may arise.

In 2018, the Board held eight scheduled meetings. At each meeting the Board received reports from:

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

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

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

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

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

The list below sets out a non-exhaustive list of the key areas of focus for the Board's activities and topics discussed during the year to 31 December 2018:

- Fit for growth – 2019 budget, debt facility, business development opportunities and product strategy.
- Performance – at every Board meeting discussed the Chief Executive Officer's Report on performance of operations, regular review of the Chief Financial Officer's Report on financial performance and quarterly market metrics.
- Governance – full-year preliminary results, Annual Report, notice of AGM and final dividend recommendation, half-yearly results and interim dividend recommendation, Modern Slavery Act, matters reserved for the Board, Committees' terms of reference, Board effectiveness review and gender pay gap.
- Risk and regulatory – annual compliance and risk reports and year-end assessment of internal control systems, presentation on GDPR, risk tolerance and risk.

The attendance of Directors at scheduled Board and Committee meetings in the year to 31 December 2018 is set out below. All of the Directors who were entitled to attend those Board meetings attended each Board meeting.

	Board Maximum 8	Audit Committee Maximum 3	Remuneration Committee Maximum 4	Nomination Committee Maximum 2	Information and Technology Committee Maximum 2
Executive Directors					
A H Foy[2]	⬢⬢⬢⬢⬢⬢⬢⬢	⬢⬢⬢	–	⬢⬢	⬢⬢
D Thompson[2]	⬢⬢⬢⬢⬢⬢⬢⬢	⬢⬢⬢	–	–	⬢⬢
Non-executive Directors					
W MacDiarmid	⬢⬢⬢⬢⬢⬢⬢⬢	⬢⬢⬢	⬢⬢⬢⬢	⬢⬢	⬢⬢
M Greenwood	⬢⬢⬢⬢⬢⬢⬢⬢	⬢⬢⬢	⬢⬢⬢⬢	⬢⬢	⬢⬢
G Bissett	⬢⬢⬢⬢⬢⬢⬢⬢	⬢⬢⬢	⬢⬢⬢⬢	⬢⬢	⬢⬢
K Olsen[1]	⬢⬢⬢⬢⬢⬢	⬢⬢	⬢⬢⬢	–	⬢⬢

1 Kelly Olsen was appointed as a Non-executive Director on 24 January 2018 and resigned on 17 October 2018. Kelly attended all the Board and Board Committee meetings that took place during the year up to that date.

2 A H Foy and D Thompson attended the Audit Committee meetings and Information and Technology Committee meetings by invitation.

Committees of the Board

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

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

The work carried out by the Audit Committee is described within the Audit Committee's Report on pages 43 to 45. The work carried out by the Nomination Committee in discharging its responsibilities is described within the Nomination Committee's Report on page 46. The work carried out by the Remuneration Committee is described within the Directors' Remuneration Report on pages 47 to 53.

Audit Committee

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

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

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

Remuneration Committee

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

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

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

The Remuneration Committee also makes recommendations to the Board on proposals for the granting of share options and other equity incentives pursuant to any employee share option scheme or equity incentive plans in operation from time to time.

Nomination Committee

The Nomination Committee is chaired by Willie MacDiarmid and also comprises Miriam Greenwood, Graeme Bissett and Alan Foy. Willie MacDiarmid, Miriam Greenwood and Graeme Bissett are considered to be independent Non-executive Directors.

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

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

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

Information and Technology Committee

This Committee became operational in 2018. The Information and Technology Committee was chaired by Kelly Olsen, an information technology specialist, whilst she was in post, and comprised Graeme Bissett, Miriam Greenwood, Willie MacDiarmid and Alan Foy (by invitation).

The Information and Technology Committee is responsible for the setting and governance of the SMS technology strategy, considering and approving any major changes to it whilst reviewing and monitoring the appropriate value for money allocation of resources to support the implementation of this strategy. It considers the development and implementation of SMS's major technology innovation projects, reviews overarching technology and process strategy and architecture, and roadmaps and makes recommendations to the Board, as appropriate, regarding significant strategic technology investments which support the Company's strategy. It also reviews and monitors the appropriateness and relevance of the Company's information management and data governance framework and systems, including those related to the General Data Protection Regulation (GDPR) and information security more generally, and in close liaison with the Audit Committee ensures that information and technology risks are identified, assessed and managed appropriately. Finally, the Committee agrees and reviews key performance indicators and operating levels relating to the provision of information technology services within the Company.

During the year, the Committee has overseen the significant investment we are making in a new Group-wide Enterprise Resource Planning (ERP) system, further evidence of our continued investment in capacity for growth. This is a business-wide transformation project which will consolidate, integrate and update our accounting, stock, fixed asset and field management systems and processes to ensure that we can effectively manage the increasing volumes of transactions and complexity of data. The Committee closely monitors the design and delivery of the system and receives regular reporting from the ERP project steering committee.

Whilst a new Committee to the Board, we consider this to be an important part of the governance and success of the business, ensuring risks and opportunities are managed appropriately, and believe that this Board-level focus on the criticality of IT will become increasingly prevalent across the Group over coming years.

Accountability

Internal control

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

The Board has reviewed the effectiveness of the Group's risk management and internal control systems, including financial, operational and compliance controls.

Whistleblowing

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

Relationship with shareholders

The Company values its dialogue with both institutional and private investors. Effective two-way communication with fund managers, institutional investors and analysts is actively pursued and this encompasses issues such as performance, policy and strategy.

Private investors are encouraged to participate in the AGM at which the Chairman presents a review of the results and comments on current business activity. The Chairs of the Audit and Remuneration Committees are also available at the AGM to answer any shareholder questions. The Chairman is available to answer questions throughout the year, upon request by investors. If investors have any matters that they wish to raise outside the timing of the AGM these can be raised using the contact details on the Group's website.

The Board actively seeks dialogue with the market as understanding what analysts and investors think about the Group is a key part of driving the business forward. Discussions with the market provide the Board with the opportunity to understand analysts' and investors' views on the Company's strategy and performance. The Board receives regular updates on the views of shareholders through briefings and reports from the Chief Financial Officer and the Group's retained advisers. In addition, the Non-executive Directors are available to meet shareholders if they wish to raise any issues separately.

Financial results and other notable news releases such as contract wins and changes to our strategy are published via the London Stock Exchange's Regulatory News Service (RNS).

Notice of the AGM is posted as an enclosure of the Annual Report and is available to download from the Company's website.

Relationship with other stakeholders

Engaging with our stakeholders strengthens our relationships and helps the business make better decisions that enable it to deliver on its commitments. The Board is regularly updated on wider stakeholder engagement feedback to stay abreast of stakeholder insights into the issues that matter most to them and the business, and to enable the Board to understand and consider these issues in its decision making. In addition to our shareholders, suppliers and customers, our employees are one of our most important stakeholder groups. The Board closely monitors and reviews the results of all of its employee engagement as well as any other feedback it receives to ensure alignment of interests. See further details on our people and development strategies in the Sustainability Report on pages 28 to 29.

Other matters

Promoting an ethical corporate culture

Various indicators are used to monitor and provide insight into the Group's culture, including employee engagement, health, safety and wellbeing measures and diversity indicators. See further details on pages 28 and 29. The state of the Group's culture is assessed through compliance reviews, internal audits and the provision of formal and informal channels for employees to speak up, including a whistleblowing hotline that allows employees to make disclosures in confidence. The Company ensures action is taken to address behaviour that falls short of the Company's expectations. The Board believes that in a fast-growing business like the Group, both in terms of employee numbers and overall size of the business, the mix of informal and formal channels provides a faster and more robust process to address matters raised by the workforce. Where Directors have concerns about the operation of the Board or the management of the Company that cannot be resolved, their concerns are recorded in the minutes of the Board meetings. On their resignation, a Non-executive Director has the opportunity to provide a written statement to the Chairman, for circulation to the Board, if they have any concerns about the operation of the Board or the management.

Brexit

The Board discussed a number of issues arising from the UK's potentially impending exit from the European Union and we are closely following developments. Our review work undertaken so far shows that Brexit will have little impact for our business (see the detailed risks assessment on page 34), and we will continue to monitor this area.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report on pages 2 to 34. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Financial Review on pages 24 to 27. The Directors confirm that, having given consideration to various outcomes of future performance and forecast capital expenditure together with the available bank facilities, they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future (being at least one year following the date of approval of this Annual Report). For this reason, they consider it appropriate to adopt the going concern basis in preparing the financial statements.

On behalf of the Board

Willie MacDiarmid
Non-executive Chairman
4 April 2019

Audit Committee

Providing effective governance

Members and attendance

Members and attendance	Meetings
Graeme Bissett (Chair)	⬢ ⬢ ⬢
Miriam Greenwood	⬢ ⬢ ⬢
Willie MacDiarmid	⬢ ⬢ ⬢
Kelly Olsen[1]	⬢ ⬢

Attending by invitation

Chief Executive Officer	⬢ ⬢ ⬢
Chief Financial Officer	⬢ ⬢ ⬢
Head of Internal Audit	⬢ ⬢ ⬢
External auditor	⬢ ⬢ ⬢

1 Kelly Olsen was appointed as a Non-executive Director on 24 January 2018 and resigned on 17 October 2018. Kelly attended all the Board and Board Committee meetings that took place during the year up to that date.

Role of the Committee

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

Main activities in 2018

- Review and approval of interim and year-end financial statements and supporting schedules, including management papers on significant areas of judgement.
- Review of reports prepared by the external auditor, including its annual audit plan and year-end results.
- Review and approval of the Group's annual Internal Audit Plan. The Committee continued to focus on the evolution of the Group's risk management and internal audit policies and procedures.

Audit Committee statement

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

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

Objectives and responsibilities

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

In fulfilment of these objectives the Committee:

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

Internal control and risk management

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

Internal audit

The Group Internal Audit function is independent and objective and its role, as defined in the Internal Audit Charter, is to add value and improve the organisation's operations. Functionally the Head of Internal Audit reports to the Audit Committee and administratively to the executive management team. The Chair meets with the Head of Internal Audit periodically without executive management present to set annual objectives and discuss any significant or emerging issues. Internal Audit uses a risk-based approach to conduct several strategic and operational audits throughout the year and these are reported and discussed at each Audit Committee meeting. Monitoring the scope, extent and effectiveness of the Group's Internal Audit activities is an agenda item at each Committee meeting. Internal Audit is also responsible for ensuring that management actions and improvement points raised within each audit report are implemented effectively and in a timely manner.

Throughout 2018, Internal Audit has worked with the Board, executive management team and members of management to support the continued development of a robust risk management and integrated assurance framework upon which it can place reliance for identifying auditable areas for the annual Internal Audit Plan. A full annual Internal Audit Plan was reviewed and approved by the Committee at the start of 2018 and the Committee has been involved in discussions around new risks the Group faces as it continues to grow, including cyber and information security, data privacy and GDPR.

Financial reporting and statutory audit

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

External audit

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

The selection of appropriate accounting policies and practices is the responsibility of management; the Committee discussed these with both management and the external auditor. Significant areas considered by the Committee in relation to the 2018 financial statements are set out below.

Area of judgement	Matter considered	Action
Capitalisation of internal installation costs	Pursuant to the acquisition of two meter installation businesses in 2016, SMS continues to carry out a significant level of in-house installation of meter assets, certain costs of which are capitalised and depreciated as part of fixed asset depreciation.	The Committee considered management's capitalisation process and the assumptions and judgements used when determining which costs are directly attributable to bringing the meter assets into use and eligible for capitalisation. The Committee was satisfied that the costs identified by management for capitalisation were appropriate, being directly attributable labour costs and an appropriate allocation of overheads.
Expected useful life and carrying value of meter assets	Due to the uncertainties associated with the timing of the domestic smart rollout, the expected useful life and carrying value of traditional meters requires significant judgement, together with the level of recoverability of termination income. These assumptions are used in deriving the depreciation rates applied and the impairment calculation performed on carrying value. Several factors are considered in assessing the expected pace of the smart meter replacement programme, including the number of smart meters still to be installed and the churn of assets.	The Committee considered the judgements made by management, the quantum and disclosure of relevant amounts. The Committee confirmed with management that the financial statements reflect an extension to the expected useful economic life of the traditional meter assets to 5 years from 1 January 2018 and an extension to the useful economic life of I&C electric meters from 15 to 20 years. The Committee considered that judgements and estimates used in support of these revised estimated were reasonable. The Committee considered the accounting estimates and judgements used to arrive at the expected useful economic life of traditional meter assets and their carrying value at 31 December 2018. Losses on disposal of de-appointed meters have been recognised after allowance for termination income and a further impairment charge was recorded at the end of the year. In addition, traditional meter stock values were reduced to zero to reflect their limited scope for redeployment. The financial statements provide detailed commentary on the estimates and judgements involved and on the financial effect. The Committee considers that the position presented in the financial statements provides a reasonable view of the carrying value of traditional meter assets. The Committee is satisfied that charges for losses on disposal, net of termination income, and for impairment of this asset class, should be recorded as exceptional items to assist understanding of the performance of the continuing meter estate comprising I&C meters and domestic smart meters as distinct from the effect of discontinued traditional meter assets. Overall, the Committee is satisfied that the approach taken by management to review the expected useful life and estimate the carrying value of meter assets is appropriate and the assumptions applied are sensible and supportable.

Existence of smart meter inventory held by third parties was a significant area considered by the Committee in the prior year. The Group's internal controls and processes around third-party-controlled inventory have been significantly improved and, therefore, this item has been removed as a significant area of focus in relation to the 2018 financial statements.

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

Graeme Bissett
Chair of the Audit Committee
4 April 2019

Appointing the best people

Members and attendance

	Meetings
Willie MacDiarmid (Chair)	⬢ ⬢
Graeme Bissett	⬢ ⬢
Miriam Greenwood	⬢ ⬢
Alan Foy	⬢ ⬢

Role of the Committee

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

Main activities in 2018

Kelly Olsen was appointed as Non-executive Director on 24 January 2018 and resigned on 17 October 2018.

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

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

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

Appointment and resignation of Non-executive Director

In January 2018 the Committee appointed Kelly Olsen as a Non-executive Director to chair a newly created Information and Technology Committee, reviewing and providing strategic guidance on development of the Company's technology programmes. Kelly's appointment was made using an external search consultancy, which has no other connection with the Group except for the provision of recruitment services.

Unfortunately, in October 2018, Kelly Olsen resigned from the Board in order to allow her to concentrate on a new external, full-time position.

Board composition and diversity

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

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

All Directors will be consulted on the composition of the Board, as to size, the appropriate range of skills and the balance between Executive and Non-executive Directors, as part of the Board evaluation process to be undertaken in 2019.

Willie MacDiarmid
Chair of the Nomination Committee
4 April 2019

Ensuring transparency

Members and attendance	Meetings
Miriam Greenwood (Chair)	
Willie MacDiarmid	
Graeme Bissett	
Kelly Olsen[1]	

1 Kelly Olsen was appointed as a Non-executive Director on 24 January 2018 and resigned on 17 October 2018. Kelly attended all the Board and Board Committee meetings that took place during the year up to that date.

Role of the Committee

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

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

The Committee's remit is as follows:

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

Main activities in 2018

- Grant of options under the existing share plan.
- "Living Wage Employer" status.
- Standardisation of employment terms.
- Non-executive Director compensation benchmarking.
- Gender pay gap reporting.

As Chair of the Remuneration Committee, I am pleased to present the Directors' Remuneration Report (the Report) for the financial year ended 31 December 2018. The Report has been prepared by the Committee and approved by the Board of Directors (the Board).

The Committee and the Board acknowledge that as an AIM-listed business the remuneration reporting requirements are not mandatory. However, we have chosen to report to our stakeholders to ensure transparency in respect of the Company's policies for Executive Directors and senior management remuneration.

The Committee will continue to adopt this approach to provide clear reporting both on past remuneration and future policy.

The Report has been arranged in the following three parts:

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

Main activities in 2018 continued

- the Directors' remuneration policy, which sets out the Group's forward-looking policy for Executive and Non-executive Directors and the key factors which were taken into account in setting the Executive Directors' remuneration policy; and
- the Annual Report on Remuneration, which sets out details of Executive Directors' remuneration for the financial year ended 31 December 2018. The Annual Report on Remuneration is subject to an advisory shareholder vote at the AGM on Tuesday 28 May 2019.

Annual statement from the Chair of the Remuneration Committee

Remuneration outcomes for the year ended 31 December 2018

The principal aim of our remuneration policy is to ensure Executive Directors and senior management are rewarded for achieving our strategy of delivering long-term value to our shareholders. The importance of aligning our remuneration arrangements with the Company's strategic priorities continues to play a crucial role in the Committee's decision making, as reflected in our decision during the year to issue share options under the existing plan as opposed to under a new Long Term Incentive Plan (LTIP) arrangement. The Company's remuneration policy is designed to ensure that the Executive Directors and senior managers are fairly and responsibly rewarded for their individual contribution to the overall long-term performance of the Company, in a manner that ensures that the Company is able to attract, motivate and retain Executives of the quality necessary to ensure the success of the Company.

Remuneration of Executive Directors is structured to ensure that:

- the fixed element of pay, salary, pension and benefits is benchmarked against comparable companies of similar size and complexity;
- a substantial proportion of Executive Directors and senior management remuneration is linked to the Group's performance and thus the delivery of our strategy; and
- remuneration rewards the meeting of specific KPIs which include, inter alia, the delivery of long-term value to shareholders, a safe operating environment, compliance with relevant health and safety policies and outstanding service to customers.

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

- transparent and promote effective engagement with shareholders and the workforce;
- easy to understand;
- not excessive, thus mitigating the reputational and behavioural risks that could arise from target-based incentive plans; and
- aligned to our culture, driving behaviours consistent with our core values.

In line with our remuneration policy, the Company has a discretionary annual bonus plan with the aim of incentivising Executive Directors on achieving demanding annual targets relating to the Company's financial performance, personal strategic objectives and health and safety performance.

Health and safety is a core priority for the Group and is ultimately the overall responsibility of the Executive Directors. Their remuneration is thus structured to ensure that they are motivated to help us achieve our health and safety goals and provide a safe and secure operating environment for all of our staff.

As set out in detail on pages 24 to 27, the Group has seen strong growth in 2018 driven by the successful and continued delivery of the UK domestic smart meter rollout, which has increased our meter and data assets under management and the annualised recurring revenue earned from these. In addition, as disclosed on page 28, there have been no significant health and safety incidents in the year. Overall, the bonus criteria were met and, as a result, the Committee approved bonus payouts to Executive Directors.

During the year, the Committee continued to focus on the Company's reporting in relation to gender pay gap legislation and assessed the progress that has been made against the requirements identified in 2017. Full reporting was achieved in 2018 and further details can be found on the Company's website. We support and encourage a culture of gender diversity amongst our workforce and aim to recruit an increasing number of females into both graduate and experienced roles. During 2018, several senior female staff were recruited into core service areas such as finance, legal, human resources, procurement and business development.

In addition, the Committee has been involved in key discussions as the Company progresses towards becoming an Employer of Choice and we are proud to confirm that, as of 1 January 2019, the Company is a Living Wage Employer. During 2018, the business has focused on the harmonisation of policies, procedures and benefits to ensure that the foundations of remuneration are consistent, fair and transparent.

Existing benefits have been reviewed and scrutinised and the Committee has been involved in decisions around enhancements to modernise the overall benefits package that we provide to our employees. All employees are now eligible for enhanced Company sick pay and benefit from life insurance.

Harmonisation of our policies and procedures will continue to be an area of focus in 2019, commencing with a Group-wide consultation project to standardise our terms of employment. Following this, additional work will be carried out to benchmark and develop a salary banding structure to bridge any further gap in gender pay. As the Group continues to build on its strategic positioning and grow its capabilities, the Committee will work to ensure that its remuneration policies and schemes remain aligned with the business and its shareholders and are an effective reward mechanism for Executive Directors and senior management.

External advice

During the period, the Committee engaged FIT Remuneration Consultants to assist with benchmarking Executive Directors' and Non-executive Directors' remuneration. FIT Remuneration Consultants is considered to be independent to both the Board and to each of the Executive and Non-executive Directors. They have not provided any other services to the Directors.

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

On behalf of the Board

Miriam Greenwood
Chair of the Remuneration Committee
4 April 2019

Directors' remuneration policy (the Policy)

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

The Policy will be displayed on the Group's website (www.sms-plc.com) within the Annual Report, under the investor relations section, immediately following the 2018 AGM (to be held on Tuesday 28 May 2019).

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

Non-executive Directors

The remuneration of the Non-executive Directors, including the Chairman, is determined by the Executive Directors after external benchmarking. Non-executive Directors are not entitled to pensions, annual bonuses or employee benefits.

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

Executive Directors' remuneration

The main components of the Policy for the year ended 31 December 2018 and the linkage to and support for the Company's business strategy are summarised below:

Purpose and link to strategy	Operation	Potential remuneration	Performance metrics
Salary			
To be set at a level which is sufficiently competitive to recruit and retain individuals of the appropriate calibre to deliver the Company's strategy and which takes into account the Director's experience and personal contribution to the Company's strategy.	Salaries are typically reviewed annually, with any changes effective from 1 January. The review takes into account: ▶ Company performance; ▶ the role, experience and performance of the individual Director; and ▶ average workforce salary adjustments within the Company. Salaries are benchmarked from time to time against comparable roles at companies of a similar size and complexity.	Increases are normally inflation and in line with other employees, or to ensure that base salaries properly reflect the size, complexity and growth rate of the Company. The Executives' base salary was reviewed on 1 January 2018 and increased for inflation in line with other employees. On 1 January 2019 the Executive Directors received an inflationary increase in line with other employees.	n/a
Benefits			
To complement basic salary by providing market competitive benefits to attract and retain Executives.	Reviewed from time to time to ensure that benefits when taken together with other elements of remuneration remain market competitive. The Company pays for private healthcare for each Executive Director and their immediate family. The Company provides a company car allowance for the CEO. The Executive Directors also currently participate in the Company's life assurance and income protection schemes.	The cost of providing these benefits varies year on year depending on the schemes' premia. The Remuneration Committee monitors the overall cost of the benefits package.	n/a

Directors' remuneration policy (the Policy) continued

Executive Directors' remuneration continued

Purpose and link to strategy	Operation	Potential remuneration	Performance metrics
Pension			
To provide retirement benefits which, when taken together with other elements of the remuneration package, will enable the Company to attract and retain Executives.	The Executive Directors (together with all other eligible staff) are able to participate in the Company's defined contribution (money purchase) pension scheme. The Company contributes a maximum of 5% of salary.	A contribution of up to 5% per annum of salary is paid into the scheme, by the Company, on behalf of the CFO. The CEO does not participate in the scheme. A pension contribution is paid into a private pension plan for the CEO.	n/a
Annual bonus			
To incentivise the achievement of the Company's annual financial targets.	The Executive Directors (together with the senior management team) participate in a discretionary, annual, performance related bonus scheme. Targets are set at the beginning of each year based on the recommendations of the Remuneration Committee. Bonuses are paid in cash based on the audited financial results.	For the Executive Directors, the maximum potential bonus is 100% of annual base salary.	For the year ended 2018, the targets were based on, inter alia, profit before tax excluding exceptionals, recurring revenues and there being no material health and safety incidences.
Individual cash bonus			
Only paid to recognise an exceptional contribution to a discrete project outside the ordinary course of business requiring the Executive Director to commit time and effort significantly over and above their normal duties.	Bonus to be paid at the discretion of the Remuneration Committee and based on the formal recommendation of the Chairman.	Maximum potential bonus at the discretion of the Remuneration Committee.	Committee to evaluate the contribution of the Executive Director to any project outside the ordinary course of the business with a particular emphasis on level of commitment made by the Executive Director.

In 2017 the Committee undertook a review of the long-term incentives on offer for Executive Directors and other senior members of staff and last year we reported that we intended to launch a new Long Term Incentive Plan (LTIP) during 2018. A further review, however, highlighted that an LTIP would not deliver appropriate incentives and shareholder alignment given the current high growth nature of the Company over a relatively short time horizon. The Committee, therefore, decided that share options would be awarded in July 2018 to Executives and senior management under the existing Unapproved Share Option Plan (the "Plan"). As with previous grants under the Plan, share options are subject to market capitalisation targets and non-market performance criteria, which include achievement of financial metrics and personal objectives. They are awarded in annual tranches and are subject to a vesting period of five years from the grant date of the first tranche.

Service contracts and policy on payment for loss of office

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

The terms applied to the Executive Directors' share options are consistent with those applied to all option holders under the Plan rules. The Plan rules contain standard provisions relating to good and bad leaver situations and the Executive Director would only retain rights to exercise share options, in respect of shares for which performance conditions have been met at the leaving date, where they are deemed a good leaver. There is no entitlement to compensation or damages for any loss or potential loss which may be suffered by reason of being or becoming unable to exercise an option as a consequence of loss of office or employment.

There were no resignations of Executive Directors during the year.

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

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

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

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

Annual report on remuneration

Directors' remuneration emoluments for the financial year ended 31 December 2018

	Fees/ basic salary £	Bonus £	Pension contribution £	Benefits in kind £	**2018 Total £**	2017 Total £
Executive						
A H Foy	348,840	294,543	—	19,998	**663,381**	620,484
D Thompson[1]	215,460	186,373	7,900	1,404	**411,137**	141,578
G Murray[2]	—	—	—	—	**—**	28,010
D Harris[3]	—	—	—	—	**—**	81,254
Non-executive						
W MacDiarmid	90,000	—	—	—	**90,000**	90,000
M Greenwood	45,000	—	—	—	**45,000**	45,000
G Bissett	45,000	—	—	—	**45,000**	45,000
K Olsen[4]	34,788	—	—	—	**34,788**	—
Total	779,088	480,916	7,900	21,402	**1,289,306**	1,051,326

1 D Thompson's remuneration for 2017 is from the date of appointment as a Director, 11 September 2017.

2 G Murray's remuneration for 2017 is to the date of resignation as a Director, 21 March 2017. £80,105 was payable to G Murray as settlement following his resignation.

3 D Harris's remuneration for 2017 is from the date of appointment to the date of resignation as a Director, 21 March 2017 to 4 August 2017. £59,500 was payable to D Harris as settlement following his resignation.

4 K Olsen's remuneration for 2018 is from the date of appointment to the date of resignation as a Director, 24 January 2018 to 17 October 2018. No amounts were payable to K Olsen as settlement following her resignation.

Annual report on remuneration continued

Directors' interests

The Directors who held office at 31 December 2018 had the following interests in the shares of the Company:

	Ordinary shares 2018 £0.01 each	Ordinary shares 2017 £0.01 each
Executive		
A H Foy	**4,480,608**	7,180,608
D Thompson	**1,335**	—
Non-executive		
M Greenwood	**16,661**	16,172
W MacDiarmid[1]	**5,923**	5,923
G Bissett	**5,300**	5,300
	4,509,827	7,208,003

1 This includes shares held by a connected person.

Directors' share options

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

	Type	Number of shares under option	Exercise price	Date of grant	Earliest date exercisable
Executive					
A H Foy	Unapproved	500,000[1]	700p	13/07/18	01/01/23
D Thompson	Unapproved	100,000	529p	01/09/16	01/09/21
	Unapproved	300,000[2]	700p	13/07/18	01/01/23

1 The number of shares under option of 500,000 comprises five annual tranches of which 100,000, being the first tranche, had been awarded as at 31 December 2018.

2 The number of shares under option of 300,000 comprises five annual tranches of which 60,000, being the first tranche, had been awarded as at 31 December 2018.

The share price at 31 December 2018 was 525.00p. The range in the period 1 January to 31 December 2018 was 485.50p to 845.00p.

Share options are awarded in annual tranches. Each tranche is measured by reference to a distinct performance period and is subject to a market capitalisation target and non-market performance criteria based on individual objectives. There is the ability to retrospectively vest tranches where a missed market capitalisation target is subsequently met in future years and the Remuneration Committee has an element of discretion in relation to the vesting of awards.

Further details of share options granted by the Company at 31 December 2018 are given in note 22.

The Directors submit their Annual Report on the affairs of the Group together with the financial statements and Auditor's Report for the year ended 31 December 2018.

Outlook

An indication of the likely future developments in the business of the Company (and its subsidiaries) is included in the Strategic Report of this Annual Report and Accounts 2018 (on pages 2 to 34) which is incorporated by reference into this Directors' Report, which satisfies the reporting requirements of section 414C (11) of the Companies Act 2016.

Directors

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

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

K Olsen was appointed as Non-executive Director on 24 January 2018 and resigned on 17 October 2018.

Political contributions

No political contributions were made during the year (2017: £Nil).

Substantial shareholdings

On 1 February 2019, the Company had been notified, in accordance with sections 791 to 828 of the Companies Act, of the following interests in the ordinary share capital of the Company:

Name of holder	Number	% held
Merian Global Investors (UK) Ltd.	19,263,144	17.12
Liontrust Asset Management	12,890,534	11.45
Hargreave Hale Ltd	6,759,104	6.01
River & Mercantile Asset Management LLP	5,697,770	5.06
Mr Steve P Timoney	4,594,344	4.08
Mr Alan Foy	4,480,608	3.98
Soros Fund Management LLC	3,924,931	3.49
Legal & General Investment Management	2,831,302	2.52
Henderson Global Investors	2,405,077	2.14
Brooks Macdonald Asset Management	2,394,269	2.13

The Company's issued share capital comprises ordinary shares of 0.01p each which are listed on AIM, a market operated by the London Stock Exchange (AIM: SMS.L). As at 31 December 2018, the issued share capital of the Company was £1,125,481 comprising 112,548,050 ordinary shares of £0.01 each.

Details of the issued share capital of the Company, together with movements in the issued share capital during the year, can be found in note 21 to the financial statements. All the information detailed in note 21 forms part of this Directors' report and is incorporated into it by reference.

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

The dividend policy is influenced by several principal risks as identified on pages 31 to 34 that could have a negative impact on the performance of the Group. The risks that could specifically have an adverse impact on the dividend policy include our working capital management, critical supplier dependency and loss of required accreditations, although we believe we can sufficiently mitigate those risks as outlined on pages 32 to 34.

In determining the level of dividend in any year the Directors follow the dividend policy and also consider the distributable reserves in the parent Company, availability of cash resources, dividend cover and future cash commitments and investment plans in line with the Group's overall strategy. See further details in note 8 to the financial statements regarding the level of distributable reserves in the parent Company at 31 December 2018.

The Directors recommend the payment of a final dividend of 3.98p per ordinary share (2017: 3.46p), payable on 6 June 2019 to shareholders on the Company's Register of Members as at the close of business on 26 April 2019. The shares will be quoted as ex-dividend on 25 April 2019. This final dividend, together with the interim dividend of 2.00p per ordinary share (2017: 1.74p) paid on 23 November 2018, makes a total dividend of 5.98p per ordinary share for the 2018 financial year (2017: 5.20p).

Financial instruments
Details of the use of financial instruments and financial risk management are included in note 18 of the notes to the accounts contained in this Annual Report and Accounts 2018, which is incorporated by reference into this Directors' Report.

Employees
The Group's policy of operating through autonomous subsidiaries has ensured close consultation with employees on matters likely to affect their interests. The Group is firmly committed to the continuation and strengthening of communication lines with all its employees.

The Group operates an equal opportunities policy, which is documented in its employee handbook and made available to employees through the intranet. This aims to ensure that all employees, potential employees and other individuals are treated fairly and equally regardless of their age, colour, creed, disability, full or part-time status, gender, marital status, national or ethnic origin, race, religion or sexual orientation.

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

Share Incentive Plan (SIP)
The SIP is HMRC approved and is open to all qualifying employees, including Executive Directors.

The Partnership Share element provides that for every share a participant purchases in the Company, up to a current maximum contribution of £150 per month, the Company will purchase one Matching Share. The Matching Shares purchased are held in trust in the name of the individual. Dividends received on shares held in the SIP are reinvested to acquire Matching Shares at their market value.

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

Under the terms of this scheme, unless they are a good leaver, the Matching Shares will be forfeited if the participant leaves the employment of the Company within three years of the award. All Partnership and Matching Shares must be removed from the trust if employment with the Company ceases.

During the year, the Company purchased 36,137 shares (2017: 40,484) from the market for the purpose of satisfying its Matching Share obligations under the SIP. The nominal value of the shares purchased was £361 (2017: £405) and the aggregate amount of consideration paid was £0.2m (2017: £0.3m).

Research and development
The main research and development activities relate to IT systems development to facilitate the metering and installations business.

Post balance sheet events

Relevant post balance sheet events requiring disclosure are included in note 27 to the accounts.

Director qualifying indemnity provisions

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

Directors' statement as to disclosure of information to auditor

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

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

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

Going concern

After making enquiries, we, the Directors, have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. We therefore continue to adopt the going concern basis in preparing the financial statements. The basis on which this conclusion has been reached is set out on page 68 which is incorporated by reference here.

Approved by the Board of Directors on 4 April 2019 and signed on its behalf below.

By order of the Board.

David Thompson
Chief Financial Officer
4 April 2019

Statement of Directors' responsibilities

In the preparation of financial statements

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

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

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

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

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

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

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

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

This responsibility statement was approved by the Board of Directors on 4 April 2019 and signed on its behalf below.

By order of the Board

Craig McGinn
Company Secretary and General Counsel
4 April 2019

To the members of Smart Metering Systems plc

Opinion

In our opinion:

- Smart Metering Systems plc's group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

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

Group	Parent company
Consolidated statement of financial position as at 31 December 2018	Balance sheet as at 31 December 2018
Consolidated income statement and consolidated statement of comprehensive income for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 8 to the financial statements including a summary of significant accounting policies
Consolidated statement of cash flows for the year then ended	
Related notes 1 to 28 to the financial statements, including a summary of significant accounting policies	

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

Basis for opinion

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

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

Conclusions relating to going concern

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

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

Overview of our audit approach

Key audit matters	▶ Assessment of the assumptions determining the expected useful life and carrying value of meter assets ▶ Appropriateness of capitalisation of overheads and other expenses within the total of costs capitalised within meter assets
Audit scope	▶ We performed an audit of the complete financial information of four components and audit procedures on specific balances for a further three components. ▶ The components where we performed full or specific audit procedures accounted for 100% of pre-tax profit before exceptional items (our audit testing covers 100% of exceptional items), 95% of Revenue and 100% of Total assets.
Materiality	▶ Overall group materiality of £1.0m which represents 5% of adjusted pre-tax profits before exceptional items.

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Assessment of the assumptions determining the expected useful life and carrying value of meter assets (£350m value of risk, PY comparative £262m) *Refer to the Audit Committee Report (page 45); Accounting policies (pages 69 and 73); and Note 10 of the Consolidated Financial Statements (page 87)* The determination of the carrying value of meter assets takes in to account their expected useful life, residual value and whether there exist any indicators of impairment. **i/ Traditional meters** Traditional meters are being phased out as a requirement of the government's smart meter roll out deadline of 2020. Management does not consider that the current deadline of 2020 will be achieved. In reaching this conclusion management has considered a number of factors including: the remaining number of domestic smart meters still to be fitted in the United Kingdom, the current smart meter deployment rate experienced by the Group, industry-wide supply constraints regarding the number of meters and the availability of sufficient engineers to fit the required number of meters in this timescale. ▶ As a result, during the year, the Group revised the useful life estimate for this type of meter. The useful life was extended from a balance of three years to five years, ending 31 December 2022, with a nil residual value by this date. Impairment indicators for the value of traditional meters were identified by management including: ▶ an increased rate of meter disposals; and ▶ less termination income received due to a higher proportion of disposals being customers whose energy is supplied by a provider with whom the Group do not have a contractual right to termination income if the meter is removed early. Management therefore conducted an impairment review.	**i/ Traditional meters** We evaluated the judgements and evidence supporting management's change in accounting estimate to a 5-year useful life to 31 December 2022 with a nil residual value at that date. As the official UK government smart deployment deadline of 2020 has not changed, we reviewed management's rationale for the remaining useful life and challenged management on the appropriateness of the extension of the useful life by: ▶ evaluating the current year smart meter deployment rate of the Group and the rate of meter disposals to confirm the reasonableness of management's estimate of 5 years; ▶ comparing the start date of smart meter roll out to that which had been assumed when the government target was set; and ▶ obtaining third-party evidence supporting management's assertion that the 2020 deadline would not expected to be achieved. We tested the depreciation rate applied during the year, re-performing the calculation of depreciation for a sample of assets. We sample tested additions and disposals during the year to source documentation. We agreed the calculation of the loss on disposal considering the termination income received and book value of assets disposed. We ensured appropriate disclosures were included within the financial statements regarding the change in estimate, the judgements taken by management and estimation uncertainty. We conducted substantive audit procedures and did not test controls.	Based on the audit procedures performed on the traditional meter asset portfolio we consider the year end carrying value to be reasonable. We consider the disclosures made around the traditional meter portfolio valuation to be adequate to explain the estimates made by management and the sensitivities should events differ from those assumed in the calculation over the year.

Key audit matters continued

Risk	Our response to the risk	Key observations communicated to the Audit Committee
	i/ Traditional meters continued We audited management's impairment calculation relating to traditional meters by: ▶ Challenging the assumptions forming the basis of the cash flows relating to future rental income together with the recoverability of termination income. We agreed rental rates and entitlement to termination income to contractual agreements. ▶ We assessed the discount rate used in the impairment model with the assistance of EY's valuation experts. ▶ We tested the mathematical accuracy of the calculation. We considered the appropriateness of the related disclosures in the Group financial statements including the classification of the loss on disposal and impairment as exceptional items.	
ii/ Other meters – smart, industrial and commercial These meters have longer useful lives, of 20 years based on the contracts in place, with a nil residual value at the end of these periods. During the year the industrial and commercial electric meter useful life was extended to 20 years from 15 years reflecting the removal of the certification requirement for these meters. The long-term contracts generate annuity type cash flows that management believe supports their carrying value. Consequently, the impairment risk is considered lower than that of the traditional meters. This risk is assessed periodically for indicators of impairment.	**ii/ Other meters – smart, industrial and commercial** We considered the appropriateness of the useful life and residual values, including industrial and commercial electric meters extending their life to 20 years, by testing a sample of contracts to agree the appropriateness of these assumptions. We tested the depreciation rate applied during the year, re-performing the calculation of depreciation for a sample of assets. We sample tested additions and disposals during the year to source documentation. We agreed the calculation of the loss on disposal. We ensured appropriate disclosures were included within the financial statements regarding the change in estimate. We conducted substantive audit procedures and did not test controls. We considered whether there were any indicators of impairment on these meters. We identified one indicator of a potential impairment relating to a loss on disposal of smart meters being removed by one energy supplier in response to their concerns relating to the SMETS1 to SMETS2 changeover. This matter is seen as being isolated to a specific period of uncertainty in 2018 due to industry-wide technical issues at that time, which have subsequently been resolved. We performed full and specific scope audit procedures over this risk area in one location, which covered 100% of the risk amount.	Based on the audit procedures performed on the other meter asset portfolio we consider the year-end carrying value to be reasonable.

To the members of Smart Metering Systems plc

Key audit matters continued

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Appropriateness of capitalisation of overheads and other expenses within the total of costs capitalised within meter assets (£25.4m, PY comparative £13.6m) Refer to Audit Committee Report (page 45); Accounting policies (page 68) and note 10 in the Group Financial Statements. As at 31 December 2018 the Group carried total meter assets amounting to £350m (2017: £262m). This includes internal operational costs that have been capitalised in the current year. As a result of the UK Government target to replace traditional domestic meters with smart meters the Group has incurred significant capital expenditure increasing the number of smart meters under management. A significant proportion of the Group's smart meters are fitted by its in-house engineering team. The significant risk relates to the appropriateness of the judgements made by management when assessing the appropriate categories and proportion of direct costs of installation, overheads and other expenses directly attributable to the installation of each meter.	We identified controls designed by management to determine the categories and proportion of direct costs of installation, overheads and other expenses directly attributable to bringing the meter assets into use by the group's in-house engineering teams and ensured these had been implemented. We evaluated the judgement applied by management to assess the appropriate categories and proportion of direct costs of installation, overheads and other expenses directly attributable to installation of meter assets. This included: ▶ Assessment of the capitalisation methodology applied and testing of the mathematical integrity of the model. ▶ On a sample basis we tested those costs capitalised to engineer time recording data and invoices to ensure they related to directly attributable costs of fitting the meter. Costs that did not relate to the meter fitting were excluded. We benchmarked the average installation cost capitalised to contracted third-party installation costs to assess the reasonableness of the amount capitalised. We performed full and specific scope audit procedures over this risk area in one location, which covered 100% of the risk amount.	Based on the results of our audit procedures, we consider the amounts capitalised for meters installed by in-house engineers to be reasonable.

In the prior year, our auditor's report included a key audit matter in relation to existence of smart meter inventory held by third parties. Recognising the improved stock processes at third-party inventory locations that occurred in late 2017 this is no longer considered to be a key audit matter.

An overview of the scope of our audit

Tailoring the scope

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

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

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

The reporting components where we performed audit procedures accounted for 100% (2017: 97%) of the Group's profit before tax (PBT) before exceptional items measure used to calculate materiality, 95% (2017: 93%) of the Group's Revenue and 100% (2017: 99%) of the Group's Total assets. We tested 100% of exceptional items (2017: 100%). For the current year, the full scope components contributed 89% (2017: 79%) of the Group's PBT before exceptional items used to calculate materiality, 86% (2017: 82%) of the Group's Revenue and 97% (2017: 99%) of the Group's Total assets. The specific scope component

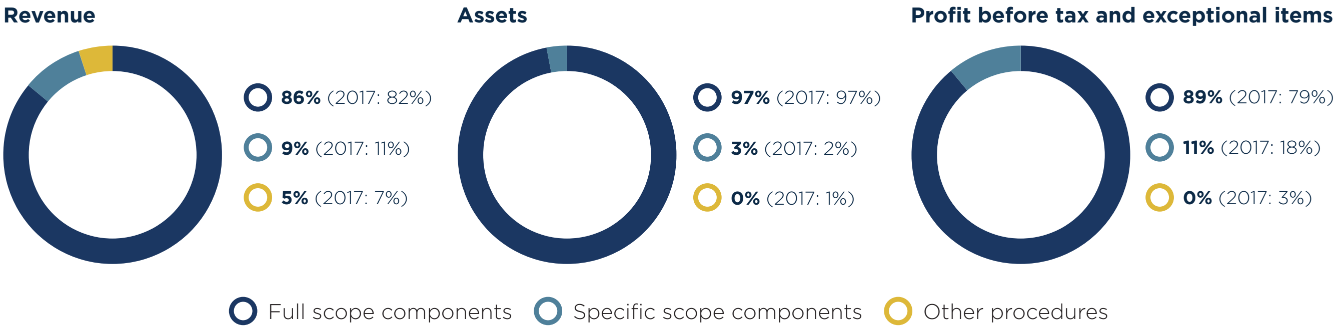
An overview of the scope of our audit continued

Tailoring the scope continued

contributed 11% (2017: 18%) of the Group's PBT before exceptional items used to calculate materiality, 9% (2017: 11%) of the Group's Revenue and 3% (2017: 2%) of the Group's Total assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

Of the remaining two components that together represent 0% of the Group's Profit before tax and before exceptional items, none are individually greater than 0% of the Group's Profit before tax and before exceptional items. For these components, we performed other procedures, including analytical review, testing of consolidation journals and intercompany eliminations to respond to any potential risks of material misstatement to the Group financial statements.

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



Involvement with component teams

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

Our application of materiality

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

Materiality

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

We determined materiality for the Group to be £1.0m (2017: £1.0m), which is 5% (2017: 5%) of pre-tax profits before £17.1m (2017: £2.0m) of exceptional items. We believe that pre-tax profits before exceptional items provides us with an appropriate materiality threshold for the users of the financial statements as the exceptional costs are considered non-recurring costs in the normal course of business.

We determined materiality for the Parent Company to be £3.57m (2017: £3.56m), which is 2% (2017: 2%) of total equity.

During the course of our audit, we reassessed initial materiality from forecast pre-tax profits to actual pre-tax profits after exceptional items and maintained our materiality at £1.0m.

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% (2017: 50%) of our planning materiality, namely £0.5m (2017: £0.5m). We have set performance materiality at this percentage due to our expectation and likelihood of misstatements taking into account the internal control environment, accounting systems and level of estimation in the financial statements.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £0.1m to £0.4m (2017: £0.1m to £0.4m).

Reporting threshold

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.05m (2017: £0.05m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Other information

The other information comprises the information included in the annual report set out on pages 2 to 56, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

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

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

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

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and Directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

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

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

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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 56, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor’s responsibilities for the audit of the financial statements

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

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

Use of our report

This report is made solely to the company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company’s members those matters we are required to state to them in an auditor’s report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company’s members as a body, for our audit work, for this report, or for the opinions we have formed.

Kevin Weston (Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor
Glasgow
4 April 2019

Notes:

1 The maintenance and integrity of the Smart Metering Systems plc’s web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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

The financial statements on pages 64 to 99 were approved and authorised for issue by the Board of Directors and signed on its behalf by:

David Thompson
Director
4 April 2019

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.

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.

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

Use of estimates and judgements continued

Critical accounting judgements continued

- 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 continue 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.

Financial assets continued

Accounting policies applied until 31 December 2017 continued

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.

Impairment continued

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.

Taxation continued

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.

Standards and interpretations continued

IFRS 16 continued

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.
- 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.

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:

31 December 2018	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total Operations £'000
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**

31 December 2017	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total Operations £'000
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

For the year ended 31 December 2018

1 Segmental reporting continued

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.

1 Segmental reporting continued

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	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 Revenue from contracts with customers continued

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

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

	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.

2 Revenue from contracts with customers continued

2 (c) Accounting policies and significant judgements continued

(i) Metering continued

Asset management services continued

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.

2 Revenue from contracts with customers continued

2 (c) Accounting policies and significant judgements continued

(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.

For the year ended 31 December 2018

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 £13,216000 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 stand-alone cash-generating unit (CGU) and its carrying amount is compared with the recoverable amount. See background information provided in the "Key sources of estimation uncertainty" section in the accounting policies. The recoverable amount is determined based on a value in use calculation, which uses the following key assumptions:

- estimated future cash flows from rental income, which are assumed to decline on a straight line basis;
- estimated future cash flows from termination income, which are derived using historical data and analysis around the risk of churn between contracted and non-contracted customers; and
- 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.

For the year ended 31 December 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:

As at 31 December 2017 and 31 December 2018	**Asset management £'000**	**Asset installation £'000**	**Energy management £'000**	**Total £'000**
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.

For the year ended 31 December 2018

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.

17 Bank loans and overdrafts continued

On 21 December 2018, the Group entered into a new revolving credit facility agreement with a syndicate of banks for £420m, available for five years (the new facility). This new facility comprises a different banking structure, gives rise to a significant increase in the Group's borrowing capacity and 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
2018[1]	**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.

18 Financial risk management continued

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.

	2018[1] £'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.

18 Financial risk management continued

Credit risk continued

Impairment of financial assets continued

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

19 Deferred taxation continued

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 Related party transactions continued

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).

Detailed remuneration disclosures are also provided in the Remuneration Report on pages 47 to 52.

(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 Trust[1] of £49,140 (2017: £Nil), David Thompson of £27 (2017: £Nil), Miriam Greenwood of £893 (2017: £723), Willie MacDiarmid[2] 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.

21 Share capital continued

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

22 Share-based payments continued

22 (a) Employee option plans continued

(ii) Fair value of options granted continued

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.

Balance sheet (extract)	31 December 2017 as originally presented £'000	IFRS 9 £'000	1 January 2018 restated £'000
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 remained unchanged upon adoption of IFRS 9 on 1 January 2018. These continue to be classified as investments held at amortised cost.

28 Impact of change in accounting policies on the financial statements continued

28 (b) IFRS 9 continued

(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.

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

Balance sheet	IAS 18 amount £'000	Remeasurement adjustment[i] £'000	IFRS 15 amount £'000
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.

Parent company balance sheet

As at 31 December 2018

	Notes	2018 £'000	2017 restated £'000
Fixed assets			
Investments	2	**19,784**	24,782
Current assets			
Debtors	3	**156,690**	155,792
Creditors			
Amounts falling due within one year	4	**627**	627
Net current assets		**156,063**	155,165
Total assets less current liabilities		**175,847**	179,947
Capital and reserves			
Called up share capital	6	**1,125**	1,124
Share premium account		**158,861**	158,592
Other reserves	7	**13,297**	12,089
Own share reserve		**(588)**	(697)
Profit and loss account		**3,152**	8,839
Equity shareholders' funds		**175,847**	179,947

No profit and loss account is presented by the Company as permitted by section 408 of the Companies Act 2006. The profit after taxation dealt with in the financial statements of the Company was £795,000 for the financial year ended 31 December 2018 (2017: £6,000,000).

The parent company financial statements on pages 100 to 104 were approved and authorised for issue by the Board of Directors and signed on its behalf by:

David Thompson

Director

4 April 2019

Company registration number

SC367563

Parent company statement of changes in equity

As at 31 December 2018

Attributable to the owners of the parent company	Share capital £'000	Share premium account £'000	Other reserves restated £'000	Own share reserve £'000	Retained earnings £'000	Total restated £'000
As at 1 January 2017	892	10,861	8,447	—	6,797	26,997
Adjustment for share-based payments	—	—	2,081	—	—	2,081
As at 1 January 2017 (restated)	892	10,861	10,528	—	6,797	29,078
Total comprehensive income for the year	—	—	—	—	6,000	6,000
Transactions with owners in their capacity as owners						
Dividends (note 8)	—	—	—	—	(4,028)	(4,028)
Share-based payments (note 7)	—	—	446	—	—	446
Shares held by SIP	—	—	—	(697)	70	(627)
Shares issued	232	147,731	1,115	—	—	149,078
As at 31 December 2017 (restated)	1,124	158,592	12,089	(697)	8,839	179,947
Total comprehensive income for the year	—	—	—	—	795	795
Transactions with owners in their capacity as owners						
Dividends (note 8)	—	—	—	—	(6,143)	(6,143)
Share-based payments (note 7)	—	—	1,208	—	—	1,208
Movement in shares held by Share Incentive Plan	—	—	—	109	(339)	(230)
Shares issued	1	269	—	—	—	270
As at 31 December 2018	**1,125**	**158,861**	**13,297**	**(588)**	**3,152**	**175,847**

Notes to the parent company financial statements

For the year ended 31 December 2018

The parent company financial statements of Smart Metering Systems plc (the Company) for the year ended 31 December 2018 were authorised for issue by the Board of Directors on 4 April 2019 and the balance sheet was signed on the Board's behalf by David Thompson. Smart Metering Systems plc is a public limited company limited by shares and incorporated and domiciled in Scotland, with its registered office at 2nd Floor, 48 St. Vincent Street, Glasgow G2 5TS. The Company's ordinary shares are traded on AIM.

1 Parent company accounting policies

Basis of accounting

These financial statements were prepared in accordance with Financial Reporting Standard 102 (FRS 102). The financial statements are prepared under the historical cost convention.

The accounting policies of the parent company financial statements follow those policies which apply in preparing the consolidated financial statements for the year ended 31 December 2018. The financial statements are prepared in Sterling and are rounded to the nearest thousand Pounds (£'000).

The Company has taken advantage of the following disclosure exemptions under FRS 102:

- section 7 Statement of Cash Flows;
- section 3 Financial Statement Presentation, paragraph 3.17(d);
- section 11 Basic Financial Instruments, paragraphs 11.42, 11.44, 11.45, 11.47, 11.48(a)(iii), 11.48(a)(iv), 11.48(b), 11.48(c);
- section 26 Share-Based Payments, paragraphs 26.18(b), 26.19 to 26.21 and 26.23; and
- section 33 Related Party Disclosures, paragraph 33.7.

Disclosure of auditor remuneration for non-audit fees is not given in the individual financial statements as the Group accounts are required to comply with regulation 5(1)(b) of the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 and present the information on a consolidated basis.

The Company is a guarantor in respect of the Group's revolving credit facilities.

Going concern

Based on the current projections and facilities in place, the Directors consider it appropriate to continue to prepare the financial statements on a going concern basis.

Investments

Investments in subsidiary undertakings are stated in the balance sheet of the Company at cost, or nominal value of the shares issued as consideration where applicable, less provision for any impairment in value.

Share-based payments

The grant by the Company of options and share awards over its equity instruments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services rendered, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to the investments in subsidiary undertakings, with a corresponding credit to equity in the Company financial statements. The credit to equity is recognised within other reserves as these amounts are non-distributable at the Company level.

Recognition of share-based payments in the Company financial statements was omitted in prior years in error. Investments and equity (other reserves) at 1 January 2017 and 31 December 2017 have thus been restated to correct for this omission. As a result, investments and other reserves at 1 January 2017 have increased by £2,081,000, being the cumulative charge for share-based payments from 2011 to 2016. Investments and other reserves at 31 December 2017 have increased by £446,000, being the charge for share-based payments recognised in the year ended 31 December 2017.

2 Investments

Cost	**2018 £'000**	2017 restated £'000
At 1 January (restated)	**24,782**	24,336
Share-based payments (note 7)	**1,208**	446
As at 31 December	**25,990**	24,782

Provision for impairment	**2018 £'000**	2017 £'000
At 1 January	**—**	—
Impairment	**(6,206)**	—
As at 31 December	**(6,206)**	—

2 Investments continued

Carrying value	2018 £'000	2017 restated £'000
As at 31 December	**19,784**	24,782

During 2018 and 2017, a number of subsidiary companies granted options and share awards to their employees over the shares of SMS. For accounting purposes, these grants are recorded as investments by the Company in its subsidiary undertakings.

An impairment of £6,206,000 (2017: £Nil) has been recognised in the year ended 31 December 2018.

Investments in subsidiaries are assessed annually to determine if there is any indication that any of the investments might be impaired. As part of a strategic Group-wide decision to use the previously acquired installation and IT resource internally to support the domestic smart meter rollout, the three trading entities acquired in 2016 no longer plan to trade externally to the Group over the medium term. These three subsidiaries have become cost centres to support the Group's operations and were in a net liabilities position at 31 December 2018. Therefore, management has taken the decision to recognise an impairment charge, writing down the carrying value of the Company's investment in these three subsidiary undertakings of £6,206,000 to £Nil.

Subsidiary undertakings

	Registered office	Holding	Proportion of shares held	Nature of business
All held by the Company:				
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.

3 Debtors: amounts falling due within one year

	2018 £'000	2017 £'000
Amounts owed by Group undertakings	**156,690**	155,792

Amounts owed by Group undertakings are repayable on demand.

4 Creditors: amounts falling due within one year

	2018 £'000	2017 £'000
Amounts due to Group undertakings	**627**	627

5 Related party transactions

During the year, the Group paid dividends to Alan Foy of £244,641 (2017: £320,973), The Metis Trust[1] of £49,140 (2017: £Nil), David Thompson of £27 (2017: £Nil), Miriam Greenwood of £893 (2017: £723), Willie MacDiarmid[2] of £323 (2017: £265), Graeme Bissett of £289 (2017: £237) and Kelly Olsen of £27 (2017: £Nil).

1 Alan Foy is a trustee but not a beneficiary.

2 Paid to a connected person.

For the year ended 31 December 2018

6 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.

The options table in note 22 to the Group's financial statements excludes further tranches of share options for which the performance objectives have still to be agreed. The further tranches, totalling 1,955,998 shares, have an exercise price of 700.0p and are exercisable between 1 January 2023 and 13 July 2028.

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).

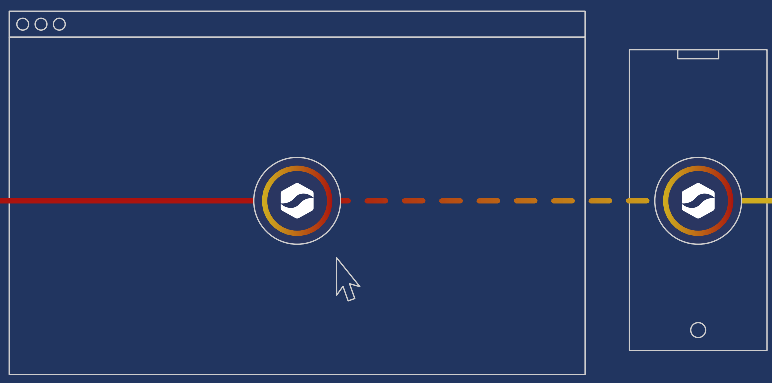
7 Other reserves

Other reserves are non-distributable and include the following items:

- a reserve that initially arose by applying merger relief under section 612 of the Companies Act 2006 to the shares issued in 2009 in connection with the Group restructuring. Additionally, the premium of £4,189,000 and £1,115,000 arising on the issue of shares as part of the acquisitions of CH4 Gas Utility and Maintenance Services Limited (CH4), Trojan Utilities Limited (Trojan) and Qton Solutions Limited (Qton) has been credited to this reserve; and
- a share-based payment reserve, arising as a result of the grant by the Company of options and share awards over its equity instruments to the employees of subsidiary undertakings in the Group.

8 Dividends

Please refer to details in note 8 of the notes to the Group financial statements.



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