



LEADING THE **ENERGY** REVOLUTION

Smart Metering Systems plc
Annual report and accounts 2017

2 0 1 7



A completely integrated service

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



“

2017 has been a year of investment in our business – building capacity to grow and deliver for our customers, particularly in the smart domestic rollout.”

Alan Foy, Chief Executive Officer

[Read more](#)

10





In this report

S

STRATEGIC REPORT

- 02 Highlights
- 04 The energy revolution
- 06 Our business at a glance
- 08 Chairman's statement
- 10 CEO's statement
- 12 Our business model
- 14 Our strategy
- 16 Financial review
- 19 Risk management and principal risks
- 21 Operational review
- 25 Sustainability

G

CORPORATE GOVERNANCE

- 28 Board of Directors
- 30 Corporate governance
- 33 Audit Committee
- 35 Nomination Committee
- 36 Remuneration Committee
- 41 Directors' report
- 43 Directors' responsibilities statement

F

FINANCIAL STATEMENTS

- 45 Independent auditor's report
- 52 Consolidated statement of comprehensive income
- 53 Consolidated statement of financial position
- 54 Consolidated statement of changes in equity
- 55 Consolidated statement of cash flows
- 56 Accounting policies
- 62 Notes to the financial statements
- 78 Parent company balance sheet
- 79 Parent company statement of changes in equity
- 80 Notes to the parent company financial statements



Read more about SMS on our
new investor website



[sms-plc.com/corporate](https://www.sms-plc.com/corporate)

Highlights

A strong financial performance

Revenue (£m)

£79.6m

+18%

2017	79.6
2016	67.2
2015	53.9
2014	42.4
2013	27.9

Pre-exceptional EBITDA (£m)

£40.3m

+22%

2017	40.3
2016	33.0
2015	27.8
2014	19.3
2013	11.8

Underlying earnings per share (p) (restated)

19.93p

+1%

2017	19.93
2016	19.66
2015	18.92
2014	12.14
2013	8.10

Annualised recurring revenue (£m)

£57.0m

+38%

2017	57.0
2016	41.3
2015	34.7
2014	26.2
2013	18.3

Financial highlights

- ▶ Revenue increased by 18% to £79.6m (2016: £67.2m)
- ▶ Total annualised recurring revenue² increased by 38% to £57.0m (2016: £41.3m)
 - ▶ Gas: meter recurring revenue increased by 15% to £36.1m (2016: £31.5m) and data recurring revenue increased by 15% to £3.0m (2016: £2.6m)
 - ▶ Electricity: meter recurring revenue increased by 283% to £11.2m (2016: £2.9m) and data recurring revenue grew 56% to £6.7m (2016: £4.3m)
- ▶ Gross profit increased by 9% to £40.4m (2016: £36.9m)
- ▶ Gross profit margin decreased by 4% to 51% (2016: 55%)
- ▶ EBITDA increased by 19% to £38.8m (2016: £32.5m)
- ▶ EBITDA margin increased by 1% to 49% (2016: 48%)
- ▶ PBT decreased by 2% to £18.0m (2016: £18.2m)
- ▶ Earnings per share decreased to 16.17p (2016: 17.33p)
- ▶ ¹Pre-exceptional EBITDA³ increased by 22% to £40.3m (restated 2016: £33.0m)
- ▶ ¹Underlying PBT^{3,4} increased by 7% to £22.2m (restated 2016: £20.7m)
- ▶ ¹Underlying earnings per share⁵ increased to 19.93p (restated 2016: 19.66p)
- ▶ Final dividend of 3.46p per ordinary share totalling 5.20p for the full year (2016: 4.10p), an increase of 27%
- ▶ Net debt at 31 December 2017 was £36.5m (2016: £94.2m), with access to cash and undrawn facilities of £243.5m (2016: £55.8m)

Operational highlights

- ▶ Total gas and electricity metering and data assets increased by 780,000 to just over 2.03 million under management at 31 December 2017 (2016: 1.25 million)
 - ▶ Total gas meter portfolio, including 3rd-party management assets, increased by 45% to 1,273,000 (2016: 881,000), with industrial and commercial (I&C) meters increasing by 14% to 163,000 (2016: 143,000). Gas data portfolio increased by 17% to 126,000 (2016: 108,000)
 - ▶ Total electricity meter portfolio increased by 301% to 309,000 (2016: 77,000). Electricity data portfolio increased by 74% to 323,000 (2016: 186,000)
- ▶ ADM™ installations up 13% to 103,000 units at 31 December 2017 (2016: 91,000) with international trials continuing
- ▶ Capital expenditure on revenue-generating assets was £122.8m (2016: £42.5m)

1 In 2017 the Board has taken the decision to change the presentation of the underlying performance measures to now include other operating income. The Board believe this income is an integral feature of the replacement of meters, particularly prevalent during the current smart domestic rollout, and will occur with greater regularity on an ongoing basis. All prior year underlying results have been restated in accordance with this new approach.

2 Recurring revenue refers to revenue generated by meter rental and data contracts. Annualised recurring revenue refers to the revenue being generated at a point in time.

3 Pre-exceptional EBITDA and underlying PBT figures are presented under our revised approach to include other operating income.

4 Underlying PBT is before exceptional items and intangible amortisation.

5 Underlying earnings per share is profit after taxation but before exceptional items and intangible amortisation, divided by the weighted average number of ordinary shares in issue.

Investing for growth

We have been at the heart of the UK energy market for 22 years and are playing a critical role in transforming and decarbonising the UK's energy networks. We are investing in a significant portfolio of smart meter assets which enable our customers to control their energy costs. Our business model enables us to exercise full ownership and control over installation and operation of the assets.

Having acted to bring the control and management of our installation services and our market-leading field management platform in-house in 2016, we are now uniquely able to provide a turnkey end-to-end service for our customers. From customer contact and appointment booking to inventory management and engineering field force, and from job scheduling to health and safety – we are investing in the capacity to ensure we provide certainty of delivery and what we have always been focused on: the highest standards of customer service.

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First platform for growth

SMS established to provide a gas connections services in gas market

- ▶ Accredited as a gas meter manager
- ▶ Brought to market a datalogger (ADM™ device)

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Second platform for growth

In July 2011 SMS began a new chapter as a public limited company when it listed on the London Stock Exchange's AIM

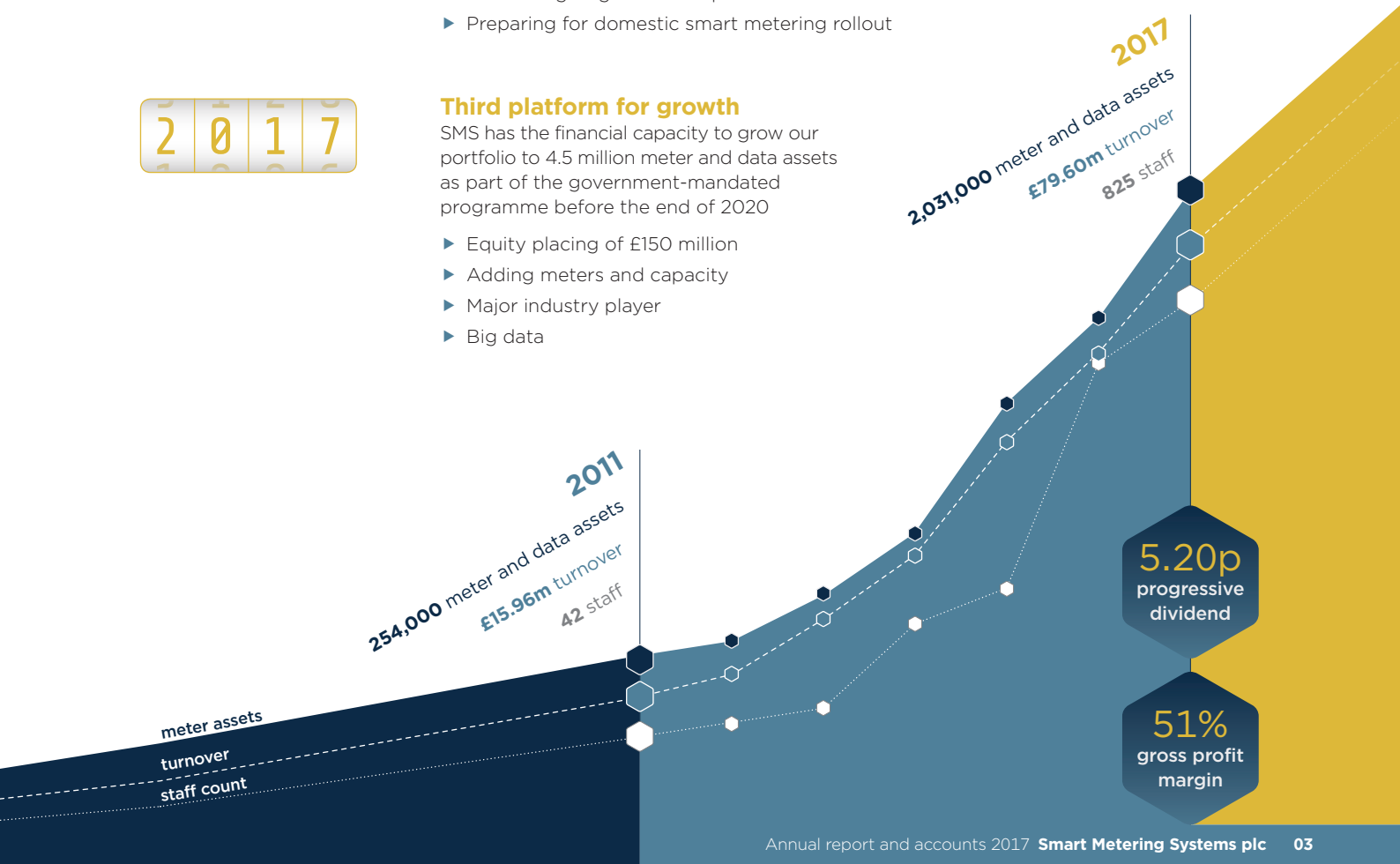
- ▶ Increasing stakeholding
- ▶ Strengthening of balance sheet to grow
- ▶ Continuing to grow meter portfolio
- ▶ Preparing for domestic smart metering rollout

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Third platform for growth

SMS has the financial capacity to grow our portfolio to 4.5 million meter and data assets as part of the government-mandated programme before the end of 2020

- ▶ Equity placing of £150 million
- ▶ Adding meters and capacity
- ▶ Major industry player
- ▶ Big data



The energy revolution

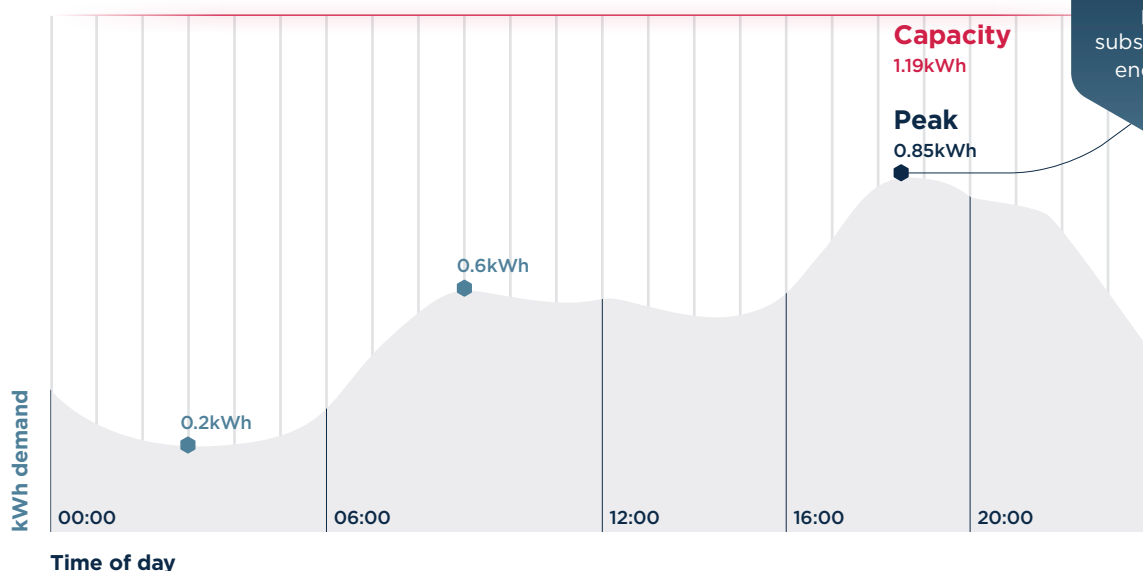
The energy system is fast evolving away from a centralised model...

The change in the UK energy market is driving new and innovative solutions to deliver cost savings and to meet carbon reduction commitments. Energy reduction through consumer behaviour is creating a large market for the installation and management of intelligent technology assets. We are uniquely positioned to be a driving force in this emerging market.

The energy model today

Today's daily consumer demand of grid energy

Source: Elexon profiling datasets



As the population and associated demand increases, so too will this peak – requiring substantial investment in energy infrastructure

The market opportunity

By the end of 2020, the UK government and Ofgem want 80% of households and businesses to have a smart meter

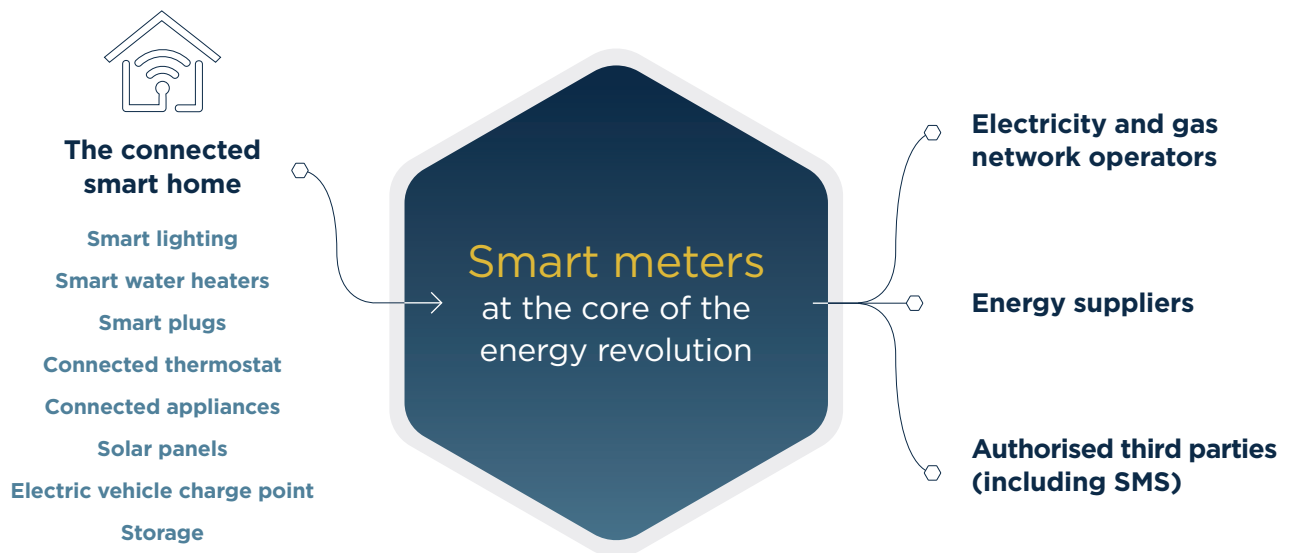
With demand for smart metering and associated services set to reach unprecedented heights over the next three years, and with over 40 million meters requiring to be installed, we are ideally placed to deliver best-in-class services to energy suppliers and their consumers through our:

- ▶ Asset investment and management services
- ▶ Fully accredited and integrated data management services
- ▶ Fully managed and scalable asset installation services



The new energy model

The energy revolution will create a new energy model



Benefits of the new energy model

Smart meters provide tangible benefits to consumers and energy suppliers alike

- ▶ Remote, regular and accurate recording of information on energy consumption and cost
- ▶ Increased energy efficiency enabling cost savings for consumers and supporting decarbonisation objectives
- ▶ Digitisation of the energy network
- ▶ Decentralised power generation
- ▶ Two-way communication across the entire grid
- ▶ Supply and demand management focused on usage
- ▶ Active consumers (e.g. "Internet of Things")
- ▶ Time-of-use smart tariffs to support load shifting



◀ The proliferation of smart meters will result in smoother energy demand in the day

Our business at a glance

A trusted partner providing an end-to-end service

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.



Our partners

SMS has long-standing multi-level relationships with energy suppliers responsible for the rollout of smart metering, connections and pursuing innovative ways to reduce consumer energy demand:

Utilities

Top six UK energy suppliers, independent energy suppliers and rapidly growing new market participants

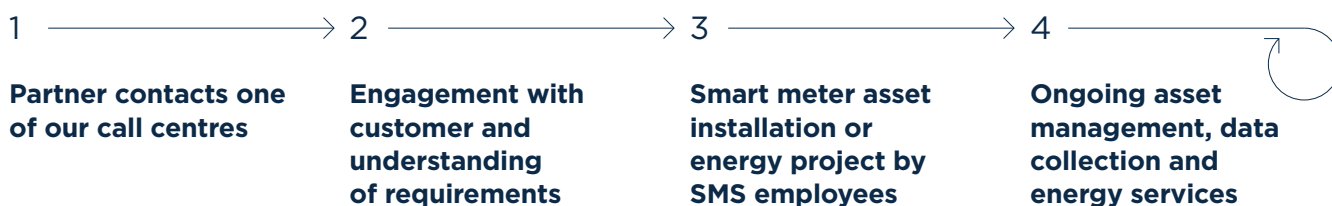
Developers

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

Enterprises

- ▶ Large supermarket chains
- ▶ Retail chains
- ▶ High street banks
- ▶ Major rail and telecoms companies

Our end-to-end service offering



Our services

Our broad service offering, future thinking and exceptional customer service experience mean continued growth and success.

This breadth of service makes us unique in the industry.

Asset installation

Direct field force management and asset installation

Read more

22



Asset management

Investing in assets and providing remote reading and data solutions

Read more

23



Energy management

Providing energy efficiency strategies

Read more

24





Our long-lasting customer relationships are testament to our unrivalled support, extensive industry knowledge and commitment to providing successful, innovative and forward-thinking solutions.

Read about how our partners enhance our offering in our business model

12

What sets us apart?

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

Key features of the smart meter profile

- ▶ Recurring, index-linked revenue
- ▶ Rental income earned from point of installation
- ▶ Significant free cash flows once debt fully amortised
- ▶ Rental contracts are long-term, evergreen agreements
- ▶ Minimal ongoing maintenance costs

Established market position

22

years of experience

Proven management team

£57.0m

recurring revenue

Progressive dividends

5.20p

per share

Priority to invest in the future

£122.8m

capital investment in meter and data assets in 2017

Chairman's statement

Willie MacDiarmid, Non-executive Chairman

Delivering our strategic plan

I am pleased with the progress made in the year, another year of strong trading activity contributing to continued growth across the business.

“
2017 has seen us make excellent progress and puts us in a strong position to continue to grow our share of the UK's smart domestic meter market.”

2017 has seen us make excellent progress, investing to build capacity through our strategic plan to enable us to install, own and manage a significantly increased number of utility metering assets for our energy supplier customers – particularly in the Smart Domestic market. This platform and increased capacity across all aspects of our operations puts us in a strong position to continue to grow our share of the UK's smart domestic meter installation programme over the next three to four years.

Whilst continuing our profitable growth, the link to our heritage remains strong, with a focus on serving our customers. Our core values of investing in our people, systems and capacity remain as important to us today as they have been over the last 22 years. We have grown to 825 staff on a national basis and our people are key to delivering excellent customer service. I would like to thank all our employees for their highly valued contribution to serving our customers.

We now manage over 2 million utility metering and data assets on behalf of a continually expanding customer base of energy suppliers in both the Industrial and Commercial (I&C) and Domestic markets. This now includes a total portfolio of over 420,000 smart domestic meters.

In November 2017, we refinanced the business, extending the term of our £280m revolving credit facility and completing a £150m equity placing, providing us with a strong financial platform to help our customers complete their domestic smart meter programmes. I would like to thank our existing and new long-term investors and funders for their support.

Delivering our strategy

Last year we strategically changed our operational delivery model to gain direct control over a large proportion of our installation capacity and the end-to-end IT platform which underpins it. The value of this approach can be seen in the last year as SMS has performed strongly – deploying more capital and generating more incremental annualised recurring revenue than in the two previous years combined. This long-term annualised and index-linked recurring revenue has increased by 38% during the year, driven by the management and systems capacity in which we have invested. This enables us to provide energy suppliers with complete confidence in our ability to deliver their mandated rollout targets.

The UK domestic smart meter rollout is a government programme, requiring each energy supplier to offer installation of a smart meter in every home and business across the UK by 2020.

Willie
MacDiarmid,
Non-executive
Chairman

This represents our largest market opportunity to increase the utility meters under management and as a result grow our index-linked recurring revenue, with c.43 million meters still to be installed across the market. Our strategy has positioned SMS to have control over the systems, people, processes and capacity to deliver on the market opportunity.

We plan to continue to increase our metering installation and management capacity and run rates with our growing customer base to enable SMS to continue to grow the two million assets currently under management.

Our strategic priorities, in 2018, will be to:

1. Continue to install and own utility metering infrastructure and secure rental and data revenues from our contracted energy suppliers in the I&C market.
2. Build on our strategic positioning and investment in capacity to take advantage of the Domestic Smart market opportunity in the UK. 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 big data, energy management, 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.

People and systems

Our Board has evolved in 2017. In March we announced that Glen Murray, who had served as Chief Financial Officer of SMS since 2011, had decided step down from the Board and leave the business. I would like to thank Glen, on behalf of the Board, for his significant contribution to SMS over the last six years. We appointed David Harris as his replacement, who unfortunately resigned in August for health reasons. In September, we welcomed to the Board David Thompson as Chief Financial Officer. David had already made a significant contribution to the SMS success story in his previous role as Group Finance Director and is ideally placed to help drive the continued growth of the Company. In January 2018, Kelly Olsen joined us as a Non-executive Director, bringing a wealth of experience as an information technology specialist. Kelly is chairing a newly created Information and Technology Committee of the Board, with a remit to review and provide strategic guidance on development of the Company's technology programmes. This is recognition of the importance of technology, information security and IT systems in providing the platform for our business to deliver a first-class customer experience. It will also provide a solid foundation for future IT investment, ultimately contributing to future shareholder returns.

We have continued to invest heavily in our people during 2017, most notably through our in-house training academy to increase and develop our capacity for the domestic smart meter rollout. This capability is also key to our leading health and safety and technical assurance management controls, which are at the heart of everything we do.

The business continues to operate with a market-focused structure, with three main service lines:

Asset management: We fund, at highly competitive rates, new meter and data assets which we install direct or adopt from third parties.

Asset installation: We have built one of the largest independent and national dual fuel metering installation services, enabling energy suppliers to achieve their mandated obligations under the government's smart meter programme.

Energy management: We have an extensive team of experts who provide a full range of energy services, including risk management, bureau, energy efficiency, carbon reduction, generation and storage.

Our technology, IT development and data security capabilities underpin all of these service lines and also provide new opportunities to innovate our services to the benefit of our customers beyond smart metering, particularly as we consider opportunities to install other long-term assets.

The safety of everyone involved in or associated with our business is of the utmost critical importance to us. "Safety Matters" (please refer to page 25) has been put at the heart of our business culture. We are proud of our assurance activities, which always ensure that health and safety is our top agenda item. However, we are not complacent and continue to invest and rigorously challenge, evaluate and assess the risks within our business to ensure that we are doing everything possible to ensure the health and safety of all our stakeholders.

Dividend

We are pleased to announce a proposed final cash dividend of 3.46p for the year ended 31 December 2017 (2016: 2.73p). In addition to the interim dividend of 1.74p (2016: 1.37p), this will make a total dividend of 5.20p (2016: 4.10p), a 27% increase. The final dividend will be paid on 31 May 2018 to those shareholders on the register (record date) on 27 April 2018 with an ex-dividend date of 26 April 2018.

Outlook

We enter 2018 with a solid financial platform, a strong and growing utility metering installation capacity and ownership proposition, and the capability to innovate our services for our customers' benefit over the long term.

We are in a strong position to continue to benefit from the Domestic Smart metering market and are continuing to increase the range of services to reduce customers' carbon emissions and transform the UK energy system for the future.

We are committed to investing in metering installation and our ownership capacity, listening to and serving our customers' needs and innovating our service proposition.

We are confident that our proven and established leadership team will continue to build on our success as we deliver our strategic plan and take the business to the next phase of growth.

Willie MacDiarmid
Non-executive Chairman

CEO's statement

Alan Foy, Chief Executive Officer

Capacity for growth

I am pleased to report on the continued strong business and financial performance of SMS for the year ended 31 December 2017.

2017 has been a year of investment in our business – building capacity to grow and deliver for our customers in the domestic smart meter rollout which stipulates that smart electricity and gas meters are to be offered to every home in the UK by the end of 2020. After transforming our business model in 2016 through three strategic acquisitions to take control of our delivery services, we have accelerated our installation activities throughout 2017. As a result we have grown to have over 2 million utility metering and data assets under management (+62%), generating £57.0m in annually recurring index-linked revenue (+38%). The scale of this opportunity is clear; we invested more capital in meter assets and added more annualised recurring revenue in 2017 than in the two previous years combined. This is illustrated by continued progress to the end of February 2018, where our portfolio of meter and data assets stood at 2.26 million generating £60.7m of annualised recurring revenue.

In order to grow these installation run rates we have continued to invest in inventory across our business. We have invested in stock to ensure we are able to meet customer demand, we have invested in a new operational delivery hub in Doncaster, we have invested in our IT systems and in our contact centre, we have invested in our health and safety and compliance management, and we continue to invest in our field engineer capacity through our accredited training school. We were particularly pleased to also add further financial capacity to the business through the successful completion of a £150m equity placement in November 2017.

“
We invested more capital in meter assets and added more annualised recurring revenue in 2017 than in the two previous years combined.”

During 2017 we materially began to roll out smart meter installations from the eight non-exclusive framework agreements with UK domestic energy suppliers signed the previous year, and were pleased to add another significant framework contract to this list in August. These nine customers supply c.2.5 million consumers and on their behalf we installed over 370,000 smart meters to take our total smart portfolio to over 420,000 meters.

Operational review

During 2017 our gas and electricity meter and data portfolio under management increased by 62% from 1.25 million to over 2 million assets. Meter assets grew by 65% from 958,000 to 1,583,000 and data assets grew by 53% from 294,000 to 449,000 data points.

Our primary financial KPI is our annualised long-term index-linked recurring revenue (derived from our recurring rental revenue from our installed meter and data asset base), which increased by 38% from £41.3m to £57.0m as of the end of 2017. This increase of £15.7m compares to an increase of £6.6m in 2016, demonstrating the size of the opportunity ahead of us, and is the primary rationale behind the £150m equity placement, which provides us with the financial capacity to take advantage of this opportunity.

This financial KPI is central to our long-term annuity financial model as, once installed, these meters provide recurring rental revenue for the lifetime of the assets, alongside providing maintenance, support and ongoing service opportunities.

Industrial & Commercial (I&C) market

SMS has a strong and proven track record in the I&C market and we continue to benefit from continued demand for our services, particularly as the government has extended the date for which advanced meters contribute to its smart rollout obligations to October 2018 in the small business segment. This means that not only do we support our contracted energy supplier customers to complete their meter exchange programmes, but we also then collect and provide meter consumption data to them and the end users for billing and energy management purposes. Demand for these services remains strong, particularly in the micro business category, and we expect that to remain the case throughout 2018.

In the I&C gas market we continue to deploy the ADM™ device, our advanced metering solution, which provides half-hourly meter read information and we now have 103,000 of these operational across the UK (increased from 91,000 at the end of 2016). We continue to see opportunities for our ADM™ device as part of other UK and international utility metering solutions.

UK Domestic market

2017 saw SMS materially embark on the rollout 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.

There are c.53 million gas and electricity meters in the UK and, as of the end of September 2017, there were 9.44 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.17% at the start of 2017 (c.9 million meters) and SMS has framework agreements with nine such independent energy suppliers, equivalent to up to 5 million of these meter points. We continue to engage with all energy suppliers in the market and believe we provide an attractive proposition to meet their installation deadlines, as we have both the financial and operational capacity to provide certainty to deliver their mandated obligations.

Energy management services

We provide the tools, expertise and knowledge to help our customers make better energy decisions, increase their control over their energy expenditure and reduce their costs and carbon footprints. Our innovative approach to monitoring and managing consumption data allows us to extract additional value for our customers and enables us to provide an integrated service covering collection and analysis of meter consumption data and the utilisation of that data to identify and deliver energy reduction activity. Our energy services therefore both take advantage of and provide opportunities for increased data recurring revenue, as well as providing a full range of energy management services in their own right. In 2017 we processed and analysed 630,000 billing points, delivered over 300 energy audits and compliance surveys and continued to identify significant opportunities for SMS to deliver turnkey energy reduction projects which we expect to accelerate in 2018.

We also provide and manage multi-utility infrastructure solutions throughout the UK. 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. Our unrivalled customer service and years of expertise continue to make us the utility connections provider of choice and we see continued and increasing demand for these services.

Alan Foy
Chief Executive Officer

Alan Foy,
Chief Executive
Officer

Our business model

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 9.4 million were exchanged by September 2017.

People

The business has control over a directly employed dedicated installation field force, supported by an in-house training academy. SMS has highly experienced senior management and divisional teams with an established track record of successful I&C smart meter rollout.

Our people **25**

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

SMS's excellent customer service is underpinned by client and service provider collaboration in planning, forecasting and, most importantly, communication.

Our business

Asset installation

Direct field force management and asset installation, targeting the domestic smart meter opportunity.



Asset and data management

Investing in assets and providing remote reading solutions, 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, who work with us to facilitate our growth plans. Our current facility and recent equity placing will fund 100% of the value of the meter assets purchased as part of a phased installation programme in line with recent contract wins.

Strategic acquisitions

The 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 and to invest in growth through additional engineering capacity.

→ Creating value

Our ability to provide both meter installation services and asset provision and management is a critical part of our value proposition.

For investors

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

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.

For employees

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

Total dividend

5.20 p

Managed meter and data assets

2.03 m

Total employees

825



Our strategy

Positioned to own utility assets in a fast-moving market

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 irregularities.



Asset installation

Nationwide field force management and asset installation, focusing always on safety, quality and customer service.

Key strategic priorities

Target the domestic smart meter opportunity.

Our current position in 2017

Substantial safe, skilled workforce in place to install domestic smart meters.

Continued investment in infrastructure and delivery capability.

Our focus for 2018

Continue to grow and build capacity, lead and drive innovation.

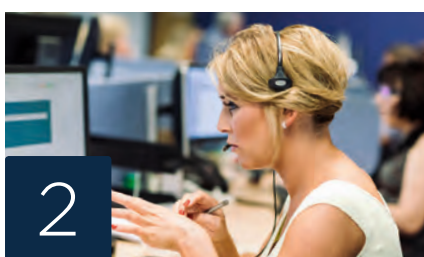
Deliver efficiency improvements.

Manage the transition to SMETS 2 smart meters as safely as possible.

Our potential for 2019 and beyond

Increase installation capacity organically through our established in-house training centres and align to our customer requirements.

Safe, customer-focused, trained and efficient workforce.



Asset management

Investing in assets and providing remote reading and data solutions.

Key strategic priorities

Increase growth rate of meter and data assets portfolio and drive recurring revenue.

Our current position in 2017

62% increase in meter and data portfolio to 2.03 million assets.

38% increase in annualised recurring revenue to £57.0m.

Our focus for 2018

Increase asset portfolio and annualised recurring revenues, and ensure full life cycle asset management.

Our potential for 2019 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, establishing additional energy asset opportunities.

Our current position in 2017

Processed and analysed over 630,000 billing points.

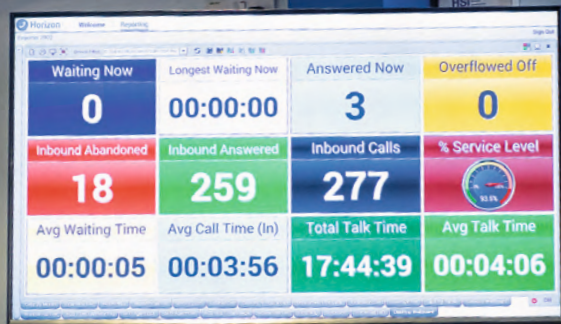
Over 300 energy audits and compliance surveys under government mandates on energy consumers.

Our focus for 2018

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 2019 and beyond

SMS believes the UK energy market will undergo significant change in pursuit of cost and CO₂ reductions. SMS aims to provide investment in new utility and energy reduction assets that will be required, along with energy expertise, technology and data services.



9

contracts

with domestic suppliers
with portfolio of over
c.2.5 million customers
signed by end of 2017

Case study

Saving our customers money

The pub and restaurant chain Mitchells & Butlers engaged with our energy services business in 2017 to manage its holistic energy requirements. We have been appointed to provide both metering and data services through SMS's innovative Energy Desk using our Smart Vision energy management software. This allows pub managers to view their half-hourly energy consumption profiles and receive consumption alerts. The provision of this service, together with an energy awareness and engagement programme, is forecast to provide c.£2m of energy savings p.a.

Financial review

David Thompson, Chief Financial Officer

Financial review

Highlights

- ▶ Revenues increased by 18% from £67.2m to £79.6m
- ▶ Annualised recurring revenue increased by 38% from £41.3m to £57.0m
- ▶ Statutory EBITDA increased by 19% to £38.8m, with pre-exceptional EBITDA¹ increasing by 22% to £40.3m
- ▶ Statutory PBT decreased by 2% from £18.2m to £18.0m, with underlying PBT² increasing by 7% to £22.2m
- ▶ Capital investment in meters of £122.8m

1 Pre-exceptional EBITDA includes other operating income.

2 Underlying PBT is before exceptional items and intangible amortisation. All underlying figures are presented under the revised approach to include other operating income.

Capital deployment and funding

2017 has been a year of significant growth and investment in our business. We have seen our portfolio of meter and data assets increase to 2.03 million, which includes 423,000 domestic smart meters, resulting in capital expenditure of £122.8m in the year. This level of capital expenditure represents a three-fold increase over what was a record year in 2016 of £42.5m.

To fund our continued growth, we undertook an exercise to raise additional equity investment and refinance our debt facility in Q4 2017. I am pleased to report that we successfully placed £150m of additional ordinary shares at the same time as refinancing our £280m debt facility in November 2017. At the balance sheet date, our net debt was therefore £36.5m, giving us a net debt to pre-exceptional EBITDA ratio of 0.90 times.

Our strategy of further significant capital deployment during the domestic smart meter rollout is clearly strengthened through the continued support from our shareholders and our banking syndicate comprising Barclays Bank plc, Santander UK plc, HSBC UK, Clydesdale Bank plc and Bank of Scotland plc.

As at 31 December 2017 the Group's available cash and unutilised debt facility stood at £243.5m.

“
High quality people
have been our largest
area of investment
as they are key to
executing our strategy.”

Change to presentation of alternative performance measures

In the prior year, other operating income was excluded from our definition of underlying performance. This income is an integral feature of the replacement of meters, particularly prevalent during the current smart domestic rollout, and will occur on an ongoing basis. It is therefore the Board's intention to present our underlying performance including this income. We hope this voluntary disclosure best allows our shareholders to understand the impact of this change.

Revised presentation to include other operating income

	2017 £'m	2016 £'m	Percentage change
Revenue	79.6	67.2	18%
Statutory profit from operations	22.6	20.5	
Amortisation of intangibles	2.2	2.0	
Depreciation	14.0	10.0	
Statutory EBITDA	38.8	32.5	19%
Exceptional items	1.5	0.5	
Pre-exceptional EBITDA	40.3	33.0	22%
Net interest (excl. exceptional)	(4.1)	(2.3)	
Depreciation	(14.0)	(10.0)	
Underlying PBT	22.2	20.7	7%
Exceptional items (EBITDA)	(1.5)	(0.5)	
Exceptional items (interest)	(0.5)	—	
Amortisation of intangibles	(2.2)	(2.0)	
Statutory profit before tax	18.0	18.2	(2)%

Original presentation to exclude other operating income

	2017 £'m	2016 £'m	Percentage change
Revenue	79.6	67.2	18%
Statutory profit from operations	22.6	20.5	
Amortisation of intangibles	2.2	2.0	
Depreciation	14.0	10.0	
Statutory EBITDA	38.8	32.5	19%
Other operating income	(3.4)	(1.1)	
Exceptional items	1.5	0.5	
Underlying EBITDA	36.9	31.9	16%
Net interest (excl. exceptional)	(4.1)	(2.3)	
Depreciation	(14.0)	(10.0)	
Underlying PBT	18.7	19.6	(5)%
Exceptional items (EBITDA)	(1.5)	(0.5)	
Exceptional items (interest)	(0.5)	—	
Other operating income	3.4	1.1	
Amortisation of intangibles	(2.2)	(2.0)	
Statutory profit before tax	18.0	18.2	(2)%

Trading

Our revenues have increased 18% to £79.6m and our EBITDA on a statutory basis increased by 19% to £38.8m.

Our margin at a Group level fell 4% to 51%. The main drivers of this reduction relate to increased depreciation on our revenue-generating assets that we disclose as a component of cost of sales, and the investment in our own engineering capacity. Whilst we capitalise certain installation costs related to the meters we fit and own, a consequence of owning our internal installation workforce is that certain costs including sales, marketing and training cannot be capitalised under current accounting rules and these costs are therefore expensed to the income statement. Had we not taken the strategic decision to acquire and grow our own installation workforce, we would be able to fully capitalise such third-party meter installation costs and our EBITDA would increase accordingly.

Statutory profit before taxation has fallen by 2% to £18.0m reflecting increased depreciation (up 41% to £14.1m) and interest costs excluding exceptional finance costs (up 78% to £4.1m) due to the significant investment in capital expenditure.

Annualised recurring revenue

Annualised recurring revenue has increased 38% to £57.0m (2016: £41.3m). In gas, recurring meter rental and management revenue increased by 15% to £36.1m and data recurring revenue increased by 15% to £3.0m, while in electricity the recurring meter rental revenue increased by 283% to £11.2m and data recurring revenue increased by 56% to £6.7m.

The significant rise in electricity asset revenue is predominantly driven by the domestic smart meter rollout; historically the business has a gas-weighted portfolio so the installation of dual fuel meter sets sees the electricity portfolio grow similarly in absolute terms, albeit from a lower base.

Annualised recurring revenue (£m)

2017	47.3	9.7	57.0
2016	34.4	6.9	41.3
2015	29.0	5.7	34.7
2014	22.5	3.7	26.2
2013	15.8	2.5	18.3

☐ Data

☒ Meter rental



David
Thompson,
Chief Financial
Officer

Financial review continued

David Thompson, Chief Financial Officer

Investment in revenue-generating assets

Our portfolio of revenue-generating assets has grown 62% to 2.03 million. The key driver for this increase relates to the domestic smart meter rollout, both the meters themselves and the associated data points. We added 371,000 domestic smart meters in the year. Through continued building of our installation capacity, be that through direct recruitment, the upskilling of existing single fuel engineers to dual fuel, or training new entrants in-house, and strategic working with selected subcontract partners, we ended the year with a record quarter of 133,000 smart meters being fitted.

The domestic smart meter rollout is also driving the increase in electricity data points, seeing an increase of 74% to 323,000.

	31 December 2017 units	31 December 2016 units	Percentage increase
Gas meter portfolio*	1,273,000	881,000	44%
Electricity meter portfolio	309,000	77,000	301%
Gas data portfolio	126,000	108,000	17%
Electricity data portfolio	323,000	186,000	74%
Total meter portfolio*	1,582,000	958,000	65%
Total data portfolio	449,000	294,000	53%
Total gas and electricity metering and data assets	2,031,000	1,252,000	62%

* Includes 3rd party meter management appointments.

Investment in capacity

2017 saw the first full year of the in-house end-to-end procurement, installation and ownership cycle of meter and data assets, pursuant to the acquisition of the installation and IT businesses in 2016. We have invested heavily in shaping these acquired businesses into the existing SMS Group to realise the value from them.

High quality people have been our largest area of investment as they are key to executing our strategy under the smart meter rollout. We have seen our employment costs increase by 41% to £30.2m as we have recruited more engineers and the technical staff to support them, and made key appointments across all our central functions.

We have further invested in our infrastructure with the opening of a new installation divisional HQ in Doncaster, to house our customer service teams, and recently opened a new 12,500 sq ft warehouse and logistics hub to add additional storage capacity for our growing meter inventory.

A key aspect of our domestic smart meter rollout is to preserve our installation run rates, and our working capital investment in meter inventory continues to grow to supply our engineers in the field. Inventory increased 171% year on year to £16.6m almost entirely due to holding increased domestic smart meters.

Exceptional items

Due to the acceleration in growth, the equity placing and the bank refinance, we have incurred significant one-off costs in the year. At the half year we reported £0.6m of reorganisation costs as we reshaped certain aspects of the business, predominantly transferring the separately acquired installation businesses into one overall operating division, and these costs now total £1.2m for the year.

The equity placing and refinancing incurred costs of £0.5m of finance costs, £0.3m of one-off professional fees that have been expensed to the income statement and £4.0m of fees that have been included within equity.

Alternative performance measures

To better reflect the underlying operating results of our business we have traditionally presented EBITDA, PBT and EPS after removing the effects of exceptional items (2017: £2.0m, 2016: £0.5m), amortisation (2017: £2.2m, 2016: £2.0m) and other operating income (2017: £3.4m, 2016: £1.1m).

As a Board we have taken the decision this year to include termination income, or other operating income, in our underlying performance measures to provide a clearer view of the actual performance and operating cash flows of the business.

Underlying:	New presentation	New presentation	Previous presentation	Previous presentation
	2017	2016	2017	2016
EBITDA	40.3	33.0	36.9	31.9
PBT	22.2	20.7	18.7	19.6
EPS	19.93	19.66	16.83	19.20

David Thompson
Chief Financial Officer

Managing risk

The attention of investors is drawn to the fact that ownership of ordinary shares will involve a variety of risks which, if they occur, may have a material adverse effect on the Group's business and financial condition and on the market price of the ordinary shares. We have a detailed and comprehensive risk management process, covering all aspects of business and operational risk.

Risk description	Mitigation	Change
Business continuity – failure or interruption of IT systems		
<p>The Group has always understood the competitive advantage that it has derived from the significant investment made in its bespoke market-leading IT systems. Failure or interruption of these systems could result in reputational damage and loss of customer confidence and ultimately have financial consequences.</p> <p>The Company's IT infrastructure is subject to failure from a variety of causes, including human error, power loss and physical or electronic security breaches. Other factors which are out of the Company's control include sabotage, vandalism, network failures, natural disasters, fibre optic cable cuts, improper building maintenance by the landlords of the buildings in which the IT infrastructure is located, and terrorism.</p>	<ul style="list-style-type: none"> ▶ The Group has an IT strategy which is designed to support our growing business needs and provides appropriate infrastructure. We regularly review our IT security policies and have successfully undergone penetration testing of our IT systems. ▶ Real-time offsite mirroring of its servers. ▶ Failover facility available for immediate redeployment of staff, enabling key operations to be serviced. ▶ Robust governance structures to ensure the information of our employees, our customers and our business is protected. 	<p> No change</p> <p>The Group continually reviews its strategy and implements changes to its IT infrastructure in line with known threats.</p>
Funding		
<p>Being well funded is fundamental to our ability to provide continued growth. The Group is reliant on securing competitively priced funding to enable the continued investment in our growing asset portfolio. The Group has periods in the year where there is a peak in working capital needs which require short-term funding.</p>	<ul style="list-style-type: none"> ▶ The Group continually reviews its capital requirements and funding options with potential funders. ▶ The Group has a long-term relationship and strong support from its existing banking syndicate which continues to support the growth of the business. ▶ The Group has recently raised £150m through an equity placing and extended a £280m revolving credit facility with a syndicate of banks which includes Barclays Bank plc, Santander UK plc, HSBC UK, Clydesdale Bank plc and Bank of Scotland plc. 	<p> Risk decreased</p> <p>The Group has secured sufficient capital to fulfil its growth strategy over the next two years.</p>
Dependent on a limited number of gas and electricity suppliers		
<p>The Group's core customers for growth are the UK gas and electricity suppliers; these are limited in number. The Group has contracts in place with key customers, which make up a large part of our existing portfolio. These contracts provide for the provision of meter rental and, in the event that our relationship with these suppliers were to be adversely affected by performance or damage to our relationship, then termination charges would apply. Damage to these relationships would have an adverse impact on the revenue generated by the Group.</p>	<ul style="list-style-type: none"> ▶ Strong track record of maintaining these long-term partnering relationships over the last 21 years. ▶ Key account managers ensure that we are listening to our customers' requirements and translating these into business deliverables. ▶ Customer service is at the heart of our business; it is what we have built our reputation on and it is what is driving our future growth. ▶ Securing new contracts with new market entrants ensures that we are able to minimise the risk of loss of assets through change of supplier by end customers. 	<p> No change</p> <p>The securing of new contracts reduces SMS's reliance on the big six suppliers.</p>
Major health and safety incident		
<p>We provide our services in a range of potentially high risk environments: in homes, in public buildings, with electrical and gas services, and as lone operatives in vans.</p>	<ul style="list-style-type: none"> ▶ The Group places significant importance on the continued investment in high quality staff and performance of health and safety reviews. ▶ We have mandatory training standards driven by job roles with a centralised training team which monitors and maintains training standards. 	<p> No change</p> <p>We have a strong and established health and safety culture which is owned by the Executive Directors.</p>

Risk management and principal risks continued

Risk description	Mitigation	Change
The Group may experience accelerated demand for its products and services		
<p>The Group expects to be able to meet its current capital expenditure from its internal resources, recent equity placing and its debt facility. The rollout of domestic smart meters may require the Group to consider supporting the working capital requirements for orders. Depending on the demand and available working capital it could adversely affect the Group's ability to expand.</p>	<ul style="list-style-type: none"> ▶ The Group maintains close relationships with funding partners maintaining regular dialogue on matters pertaining to trading and risk in the Group to give Directors confidence that future growth can be funded. ▶ We maintain a strict internal review process on covenant compliance to ensure we remain in line with the requirements of our banking documents. ▶ Opportunities are continually reviewed and assessed. 	 Risk increased The value of opportunities has significantly increased.
Changes in government policy		
<p>Current government policy is that smart meters are due to be offered to every home in the UK by 2020; this requires a large amount of capital investment. A large part of the Group's growth strategy is geared around the exchange and delivery of these meter assets. Any changes in legislation may adversely affect the Group.</p>	<ul style="list-style-type: none"> ▶ Actively involved with the Department of Business Energy & Industrial Strategy (BEIS) in shaping future policies. ▶ Industry-respected management team, playing a major role within important working groups. ▶ Lobbying on market-specific consultation, ensuring we understand the impact of a change in policy whilst having an active voice in the shaping of future policies. 	 No change The foundation stage of Domestic Smart is being rolled out and adoption by new entrants is high.
Reliance on performance of subcontractors		
<p>The Group relies on a number of third-party partners to deliver its meter exchanges and maintenance activities. Failure of one of these partners to deliver to the high expectation demanded by ourselves and our customers could result in loss of customer confidence or loss of accreditation. The Group took a strategic decision to safeguard its service standards through the acquisition of two of its third-party contractors.</p>	<ul style="list-style-type: none"> ▶ The acquisitions of CH4 and Trojan in 2016 significantly reduced the Group's reliance on third-party providers and enable the Group to train and retain new dual fuel engineers to meet the demands of the domestic smart metering rollout. ▶ The Group monitors and independently audits third-party partners' accreditations, working practices and employee competencies. 	 No change Resource availability will become increasingly tight with the anticipated increase in demand.
Unforeseen delays and cost overruns when rolling out new, and upgrading existing, products		
<p>The Group may experience unforeseen delays and expenses in connection with a particular project or initiative. Although the Group has budgeted for expected costings, additional expenses may well be incurred. With the rollout of domestic smart resource retention, training and systems will be key. Inability to address these could negatively affect the Group.</p>	<ul style="list-style-type: none"> ▶ The Group has considerable experience in forecasting and managing project implementation timetables. ▶ The Group has taken steps, through its recent acquisitions, to ensure that it is able to mitigate future resource constraints that would otherwise have significantly hindered its ability to mitigate the above challenges. 	 Risk increased Complexity and challenges of such a large rollout within truncated timelines.
Loss of required accreditations		
<p>The installation and maintenance of electricity and gas meters within the UK is a regulated activity and, as such, the organisations need to maintain the required industry accreditations which are reviewed on an annual basis. Loss of these accreditations would mean that the Group would no longer be able to operate.</p>	<ul style="list-style-type: none"> ▶ The Group has a dedicated compliance team which is responsible for ensuring that all members of staff are aware of our obligations. Routine audits are carried out and reported to the senior management team to ensure that compliance is maintained to the highest standard. 	 No change Robust audit processes ensure full compliance.

Operational review

John Hall, MD of Asset Installation

Tim Mortlock, MD of Asset, Data & Energy Management

Q&A



“

We have made a very strong start to 2018.”

How does the new management structure work across the divisions?

John is responsible for all activities associated with the creation and deployment of new meter assets, including all stock, sales, account management and engineering operational delivery. Tim is responsible for the management of those meter and data assets once they are on the wall and the other services we provide across both connections and energy management. This structure provides a clear separation of responsibility between asset installation and ongoing asset management and service provision but we work very closely together to ensure we provide a co-ordinated approach across the divisions.

What are the future market opportunities for each of the divisions?

The immediate opportunity for both asset installation and management is that of the smart domestic meter rollout, which the business has strategically positioned itself to be able to deliver. However, in many respects this will provide a foundation for the provision of wider data and energy management solutions enabled by the smart meter rollout, along with the opportunity to deploy a wider asset infrastructure class in the longer term across areas such as generation, storage and electric vehicle charging points.

SMS is a national business with offices up and down the UK; how does the coverage differ for the divisions?

All our divisions operate on a truly national basis, but with centres of excellence and management controlling operational delivery. Our meter installation business operates across a national footprint but with an operational hub based in Doncaster, where our training centre is also based. Our asset management, connections and energy management services are centred in both Glasgow and Cardiff, all of which is supported by a technology and IT hub based out of Cambridge. We focus on keeping close to our customers across all of our divisions.

What were the key client wins for 2017?

We were pleased in August to be able to announce a new meter rental agreement with Utility Warehouse to provide a minimum of 100,000 new meter installations and we continue to work with them and our entire client base to roll out smart metering across their customer portfolios. We have also continued to extend our energy and connections customer base, including new provision of services to the likes of Mitchells & Butlers and Liberty Global/Virgin Media.

What is your outlook for 2018?

We have made a very strong start to 2018 and aim to continue to build operational capacity to deliver our customers' requirements across both the I&C and Smart Domestic market segments. As this operational capacity grows and pressure increases on energy suppliers to meet their domestic smart rollout obligations, we expect to continue to see increasing opportunities for our proven capability to critically be able to control delivery to the highest customer services. We also expect 2018 to begin to see the transition to "SMETS 2" smart meters and, whilst this will provide some operational challenges, we are ensuring that we have the systems and processes to manage this business change. We also continue to place emphasis on the development of wider connections and energy management services, often mutually benefiting from data collection and provision opportunities. As a result of all these activities, we expect strong growth in our asset bases and recurring revenue streams across all market segments.

Asset installation

Division highlights

Revenue (£m)

£ 2 7 . 5 m

Gross profit (£m)

£ 9 . 5 m

Review of the year

In 2017 we concluded the integration of our acquisitions of CH4 and Trojan into the business and further strengthened our in-house installation capability to deliver Group meter assets. We have progressively driven efficiency improvements through the business during the year. Following the expected meter availability challenges in the first half of the year, we took the opportunity to focus on increasing our run rates and installation capacity month on month, investing in both the engineering workforce and required supporting infrastructure to support this growth. This increased capacity and in-house ability to grow further provides confidence to our clients of a secured and high quality workforce able to meet their requirements.

We are committed to continue to grow the asset installation capacity, but we are also focused on improving efficiency of delivery across all aspects of the business, not forgetting our modus operandi, which will always be "Safety First". The capacity investment extends to our in-house training centre and industry-leading technical quality assurance team, which supports this and provides confidence to our clients, for quality and our ability to ramp up our installation capacity.

Business model

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

- ▶ Technical assurance – training, development and competency management of all our engineering workforce.
- ▶ Customer service – ensuring we have a dedicated customer-facing team who is responsible for customer experience, account management and ensuring we always live up to our service ethos.
- ▶ Customer contact – innovation in customer appointment booking and management to ensure we maximise delivery opportunities across client portfolios.
- ▶ Scheduling – whilst driving efficiency, making sure 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 the best 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 clients 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.

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.

Our strategy for delivery:

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



Case study

Asset installation

SMS is delighted to be working closely with Utility Warehouse, a leading energy supplier in the UK. Utility Warehouse has embarked on an extensive programme to deliver smart metering and the associated benefits to their customers and has engaged with SMS to support them for ongoing smart meter installations.

Asset management

Division highlights

Revenue (£m)

£ 4 8 . 7 m

Gross profit (£m)

£ 2 9 . 7 m

Review of the year

2017 was a milestone year for the asset management business, with capital deployed and additional annualised recurring revenue greater than the two previous years combined, largely as a result of the business materially stepping into the Smart Domestic market opportunity.

Annualised recurring revenue from meter rental increased by 37% to £47.2m and, for both gas and electricity data services, increased by 40% to £9.7m. As a result we added £15.7m annualised index-linked recurring revenue to take our total to £57.0m. We ended the year in Q4 adding an average of £1.5m recurring revenue each month.

In 2017 we added Utility Warehouse to our contracted customer list in the domestic dual fuel sector, meaning we have framework contracts in place with nine of the largest independent energy suppliers, providing them with a fully managed service for the installation and management of assets.

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 is 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:

- ▶ Commercial management of all 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 assets.
- ▶ 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 – which 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 allows us to control all aspects of operational delivery, working in partnership with our clients 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, the installation of new asset classes partly enabled by the UK's smart metering rollout.

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.

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.

Our strategy for delivery:

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.



Case study

Asset management

During 2017 SMS Meter Assets, working with First Utility Limited, the largest independent UK domestic energy supplier, added a significant number of smart meter assets to the initial volumes in 2016 and our relationship continues to develop resulting in 2018 with an extension to the existing contract for a further 220,000 smart meters.

Energy management

Division highlights

Revenue (£m)

£ 3.4 m

Gross profit (£m)

£ 1.2 m

Review of the year

Our energy management division has focused in 2017 on providing a platform for growth, investing further in data presentation and analytics systems and turnkey delivery capability for energy efficiency, generation and storage investment projects. We have also accelerated our focus on developing more long-term customer relationships and ensuring we maximise opportunities to derive increased data recurring revenue from our energy services activity and vice versa. Our greatest investment, however, is in our staff, whose expertise and knowledge provide the foundation for our services across both energy services and utility infrastructure and connections services. We see continued and increased demand for our services and have been pleased to put in place extended long-term contracts with our entire key customer base.

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 also provide recurring revenue opportunities for our metering and data collection services.

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.

Our strategy for delivery:

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.



Case study

Energy management

Our energy services business has been working with the national hotel chain Travelodge for a number of years, supporting them across their energy purchasing, water procurement, utility invoice validation and energy management requirements. SMS has been chosen as the principal contractor and is rolling out the full LED lighting project to reduce energy and carbon consumption across Travelodge's entire 500-site portfolio.

Our people are integral to our business

People management and development

SMS has over 825 employees nationwide, united by our culture which has developed over more than 20 years. Our people are highly skilled, do a professional job and, above all, do it in a safe manner. Our people are our biggest asset.

Learning and development continues to be an area of focus for us, as we firmly believe that investment in our employees has a direct and positive impact on our employee retention rates and the engagement levels of our staff. Each part of the business has training programmes in place to provide our employees with the necessary skills to perform their role; training is a combination of on-the-job learning and specific skill development through training courses. Our in-house, fully accredited training academy means that we have the ability to recruit and train our own workforce. With further investment we are increasing capacity and capability. In 2017 we delivered over 4,400 days of training across the Group. Many of our training programmes are tailored specifically for SMS employees and utilise real-life scenarios. This approach results in training programmes which are standardised and which reinforce our core values and helps to create a workforce that represents the high levels of performance the business demands.

We recognise that it is in the best interests of the Company and of our employees to create standardised processes wherever possible and to utilise technology to consolidate our information systems. As part of this journey, we are rolling out several nationwide initiatives to further develop these systems.

Health and safety

Protecting the health and safety of our people, customers, suppliers and members of the public is a core priority for the Company. We remain committed to being a safe, secure and reliable organisation and act diligently to protect our employees' health and safety. As a Company, our emphasis

on safety training cannot be overstated and our vision is that together we will create an injury-free workplace where everyone goes home safe and healthy every day of their working life.

The Executive Directors have overall responsibility for health and safety and our commitment to health and safety is reflected in our Health and Safety policy. Our Executive Directors are supported by the Head of Group SHE, whose responsibility is to ensure that the Health and Safety policy, standards and procedures are effective and implemented throughout SMS. 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. A rigorous approach to risk management is absolutely essential if we are to avoid accidents which could cause injury to people and damage to property and reputation. Through the

organisation's risk management process we have identified key health and safety risk factors and have put mitigating actions in place.

Under our Safety Matters initiative, which includes significant investment in staff training, regular health and safety advice for employees, a quarterly forum and an internal network of health and safety champions, we are actively reaffirming our dedication to upholding the highest in health and safety standards, ensuring our workforce keep themselves, their colleagues and the general public out of harm's way. Our customers can be assured that we meet the highest of industry standards, codes and practices, ensuring that any work we carry out is of the utmost safety and quality.

SafetyMatters

Think Safe. Work Safe. Be Safe.



Sustainability continued

Social responsibility

The Group is committed to good environmental practice and places great importance on the impact of its operations on the environment. 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. 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 are proud that all of our contractors operate within our Environmental policy and contractor's code of conduct before carrying out any work on behalf of SMS.

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, briefings and formal and informal meetings.

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.

We have an Anti-Corruption policy in place which relates to compliance with the Bribery Act 2010. We also provide a confidential whistleblower service. This is managed by a specialist third-party provider giving all colleagues across the Group the opportunity to raise concerns. The outcome of any report or incident investigation is summarised and provided to the Audit Committee for its review.

During 2017 we conducted an evaluation of the implications of the UK Modern Slavery Act 2015.



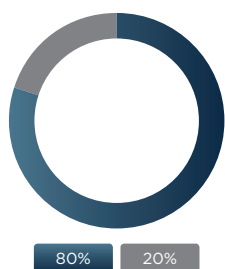
Our commitment to diversity means creating a working environment that is respectful and engaging and that creates opportunities for all. We not only believe this is right thing to do but that it makes sound business sense as it helps to enhance productivity, quality and innovation.

We employed on average 791 people in the UK during the year. As at the financial year ended 31 December 2017 the Group employed 825 people.

The gender breakdown at 31 December 2017 has been set out as follows:

■ Male ■ Female

BOARD OF DIRECTORS



SENIOR MANAGEMENT



OTHER EMPLOYEES



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.

Craig McGinn

Company Secretary and General Counsel for the Group

CORPORATE GOVERNANCE

- 28 Board of Directors
- 30 Corporate governance
- 33 Audit Committee
- 35 Nomination Committee
- 36 Remuneration Committee
- 41 Directors' report
- 43 Directors' responsibilities statement



Board of Directors



Willie MacDiarmid Non-executive Chairman

Date of appointment

14 April 2014, Chairman 26 May 2016

Committees

Audit, Remuneration,
Nomination (Chair)

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 Rigg, 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 Chief Executive Officer

Date of appointment

24 December 2007

Committees

Nomination

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 five 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

Committees

None

Background and experience

David has operated at both Divisional and Group Finance Director level within SMS plc 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



Miriam Greenwood
Senior Independent
Non-executive Director

Date of appointment
3 February 2014

Committees
Audit, Remuneration (Chair),
Nomination

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 Mithras Investment Trust plc and Eclipse Shipping Limited. She has also recently been appointed as a non-executive on the board of Telit Communications plc.



Graeme Bissett
Non-executive Director

Date of appointment
1 June 2016

Committees
Audit (Chair), Remuneration,
Nomination

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.



Kelly Olsen
Non-executive Director

Date of appointment
24 January 2018

Committees
Information and Technology (Chair)

Background and experience
An experienced technology professional who has held chief information officer (CIO) roles internationally as well as in the UK. Kelly has spent 30 years leading technology teams and delivering a number of major transformations including the building of a smart energy business in the Nordics whilst working for Capgemini Plc.

External appointments
Kelly is a director of Olsen Purdy Associates Ltd, an independent technology consultancy.



Craig McGinn
Group Company Secretary and
General Counsel for the Group

Background and experience

Craig is a qualified corporate and banking lawyer with over 17 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.

Craig is also a director of River Clyde Homes, a charitable registered social landlord based in the west coast of Scotland.

Corporate governance

As an AIM-listed company, the Company is not required to comply with any specific requirements for corporate governance procedures. Nevertheless, in considering its own arrangements for governance, the Company has regard, so far as is practicable and appropriate for a company of its size and nature, to the provisions of the UK Corporate Governance Code, and to the recommendations of the Quoted Companies Alliance (QCA). The key elements of the Company's corporate governance arrangements are described below.

Board structure

The Board places great importance on corporate governance and has sought to present a fair, balanced and understandable assessment of the Group's positions and prospects in the Annual Report and Accounts for 2017, providing the information necessary for shareholders to assess the Group's performance, business model and strategy.

The Board currently comprises a Chairman, a Chief Executive Officer, Chief Financial Officer and three Non-executive Directors, one of which is a Senior Independent Non-executive Director; their details are set out in the Board of Directors section.

During the year, a number of changes have been made to the Board. All of the changes made in 2017 and to date in 2018 are set out below:

- ▶ Glen Murray resigned from the Board as a Director and Chief Financial Officer on 21 March 2017;
- ▶ David Harris was appointed as Chief Financial Officer on 21 March 2017 and resigned on 4 August 2017;
- ▶ David Thompson was appointed as Chief Financial Officer on 11 September 2017; and
- ▶ Kelly Olsen was appointed as a Non-executive Director on 24 January 2018.

The Board is responsible for formulating, reviewing and approving the Group's strategy, budgets and corporate actions.

In 2017, the Board held ten scheduled meetings.

At each meeting the Board received reports from:

- ▶ the CEO on health and safety, strategic, operational and business developments, and investor relations;
- ▶ the CFO 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. 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:

- ▶ Fit for growth – 2018 budget, equity placement and debt facility, business development opportunities and product strategy.
- ▶ Performance – at every Board meeting discussed the Chief Executive'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 management plans.

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 of corporate governance policies.



The Board meets regularly to review the progress of the Company and to discuss the measures required for its future development. Directors are provided in advance with a formal agenda of matters to be discussed at each meeting and with the detailed information needed to monitor the progress of the Company. Separate strategy meetings and meetings with senior executives are also held throughout the year. Records of all meetings and the decisions of the Board are maintained by the Company Secretary. All of the Directors are subject to election by shareholders at the first 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. 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.

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 as 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.

The Board recognises that a healthy corporate culture is fundamental to SMS's business purpose and strategy. Senior management has a critical role in setting the tone of our organisation and championing the behaviours we expect to see. Management is committed throughout the year to highlight the values, beliefs and business approach to health and safety, business integrity, customer experience, diversity and inclusion. Various indicators are used to monitor and provide insight into SMS's culture, including employee engagement, health, safety and wellbeing measures and diversity indicators. The state of our culture is assessed through compliance reviews, internal audit and formal and informal channels for employees to speak up. We ensure action is taken to address behaviour that falls short of our expectations.

Board evaluation

The Company has implemented a formal process of annual performance evaluation for the Board, its Committees and individual Directors. 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 in order to optimise the process.

The Company has Directors' and officers' liability insurance in place.

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 Financial Officer and Head of Internal Audit.

Corporate governance continued

Board evaluation continued

Audit Committee continued

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 auditor, advising on the appointment of the external auditor 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

During the year the Remuneration Committee comprised Miriam Greenwood (Chair), Willie MacDiarmid and Graeme Bissett. 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

During the year the Nomination Committee was chaired by Willie MacDiarmid and also comprised Miriam Greenwood, Graeme Bissett and Alan Foy. The Nomination Committee considers the selection and re-appointment of Directors. It identifies and nominates candidates to fill Board vacancies and regularly reviews the structure, size and composition (including the skills, knowledge and experience) of the Board and makes recommendations to the Board with regard to any changes.

Information and Technology Committee

The Board took the decision to form a new committee which will become operational in 2018. The Information and Technology Committee will be chaired by Kelly Olsen and also comprise Graeme Bissett, Miriam Greenwood, Willie MacDiarmid and Alan Foy. The Information and Technology Committee will consider the development and implementation of SMS's major technology innovation strategies, review overarching technology and process strategy, architecture and roadmaps and make recommendations to the Board, as appropriate, regarding significant and/or strategic technology investments which support the Company's strategy.

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.

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 wrong doing. 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 will be available at the AGM to answer any shareholder questions.

We actively seek dialogue with the market as understanding what analysts and investors think about us is a key part of driving our business forward. Discussions with the market provide us 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 CEO and our retained advisers. In addition, our 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.

Other matters

Brexit

The Board discussed a number of issues arising from the UK's vote to leave the European Union in June 2016. We are closely following developments arising as a result of the UK's decision to leave the European Union. Our review work undertaken so far shows that Brexit will have little impact for our business and we will continue to monitor this area.

Going concern

The Directors confirm that, having given consideration to various alternative 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. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

On behalf of the Board

Willie MacDiarmid

Non-executive Chairman

13 March 2018

Audit Committee



Members

- ▶ Graeme Bissett (Chair)
- ▶ Miriam Greenwood
- ▶ Willie MacDiarmid

Secretary

- ▶ Craig McGinn

Attending by invitation

- ▶ Chief Executive Officer
- ▶ Chief Financial Officer
- ▶ Head of Internal Audit
- ▶ External auditor

Number of meetings in 2017

- ▶ Three

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 2017

- ▶ The Committee had particular focus in 2017 on the systems and controls necessary to support the growth of the business, the development of the Group's end-to-end delivery and asset management business model, inventory control, funding adequacy and related accounting policies and external audit requirements.
- ▶ The Committee also monitored and guided the evolution of the Group's risk management and internal audit procedures.

Audit Committee statement

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 separately with the external auditor without others 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 and the Board, as a whole, 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

Internal audit undertakes financial and operational audits across the Group using a risk-based methodology and in accordance with the changing risk profile of the Company. Monitoring and review of the scope, extent and effectiveness of the activity of the Group's internal audit activities is an agenda item at each Committee meeting. The Committee receives updates from the Head of Internal Audit on audit reports, the results of any unsatisfactory audits and the action plans to address these areas. The Chair also meets with the Head of Internal Audit without management being present to set annual objectives and any significant issues arising from their work. Due to the increasing pace of change of the business, initiatives are continuing to be implemented to evolve and strengthen the effectiveness of internal audit.

Audit Committee continued

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 Ernst & Young its detailed audit plans prepared in advance of the audit, which set out its assessment of key audit risks and materiality accounting policies, practices and judgements.

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 2017 financial statements are set out below.

Graeme Bissett

Chair of the Audit Committee

13 March 2018

Area of judgement	Matter considered	Action
Capitalisation of internal installation costs	Pursuant to the acquisitions of two meter installation businesses in 2016, SMS carries out a significant level of in-house installation of customers' meter assets, the 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 assessing whether expenditure should be capitalised.
Existence of smart meter inventory held by third parties	Due to forecast demand for smart meters, SMS has increased the level of inventory held and managed by two third parties at external warehouses.	The Committee considers the controls and procedures performed by management in relation to existence of inventory held by third parties.
Recoverability of termination income and the impact on traditional domestic meter assets' residual values	Termination income is an ever more prevalent income stream within the SMS business due to the domestic smart rollout and the level of recoverability requires significant judgement. The Group considers each significant customer individually with the relevant circumstances to which it relates, taking into account a number of factors. This informs the judgements made with respect to residual values.	The Committee considered the judgements made by management, the quantum and the disclosure of relevant amounts. The Committee is aware that the Board receives a report on termination recoverability and provisioning each month and has assessed the Group's processes for calculating and regularly monitoring termination income recoverability. The Committee confirmed with management that there has been no change to expected useful economic life and that judgements and estimates were reasonable and appropriate.

Nomination Committee



Members

- ▶ Willie MacDiarmid (Chair)
- ▶ Graeme Bissett
- ▶ Miriam Greenwood
- ▶ Alan Foy

Secretary

- ▶ Craig McGinn

Number of meetings in 2017

- ▶ Two

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 2017

- ▶ Appointment of two Chief Financial Officers.
- ▶ Recruitment of Non-executive Director.

The Nomination Committee is currently made up of the Non-executive Directors, each of whom is independent, and one Executive Director. The main focus for the Committee in 2017 was the appointment of a new Chief Financial Officer. You will see from the table that the Committee met on two occasions. In addition, we held a number of informal meetings and discussions with the Chief Executive Officer and others.

Appointment of Chief Financial Officer and Non-executive Director

In March 2017 the Committee appointed David Harris as Chief Financial Officer. However, unfortunately in August 2017 David Harris resigned from the Board due to health reasons. Subsequently the Committee appointed David Thompson as Chief Financial Officer in September 2017. A formal and transparent procedure was followed by the Company when carrying out this search. When considering candidates the Board took into account a number of factors including the skills and expertise of the candidates.

On 24 January 2018, the Company announced the appointment of Kelly Olsen as a Non-executive Director. The Committee was keen to identify candidates with experience in information technology given the Company considers technology to be a core component of the business. Kelly will chair a newly created Information and Technology Committee of the Board, reviewing and providing strategic guidance on development of the Company's technology programmes.

Board composition and diversity

Our policy is to have a broad range of skills, background 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 the 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 2018.

Willie MacDiarmid

Chair of the Nomination Committee

13 March 2018

Remuneration Committee



Members

- ▶ Miriam Greenwood (Chair)
- ▶ Willie MacDiarmid
- ▶ Graeme Bissett

Secretary

- ▶ Craig McGinn

Number of meetings in 2016

- ▶ Three

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; details of attendees at these meetings is provided in the Corporate Governance Statement on page 32. We invite attendance at the meetings, as appropriate.

The Committee's remit is as follows:

- ▶ Determine and agree with the Board the policy for total remuneration of the Executive Directors.
- ▶ 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 amount of awards and the individual awards to Executive Directors and the senior management.
- ▶ Review Group-wide salary increases.
- ▶ Review any major changes in employee benefits structures throughout the Group.

Main activities in 2017

- ▶ Executive Directors and Non-executive Director compensation benchmarking.
- ▶ LTIP and CSOP redesign.
- ▶ 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 2017. 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-quoted business the remuneration reporting requirements set out under section 420(1) of the Companies Act 2006 are not mandatory. However, we have chosen to report to our stakeholders to ensure transparency in respect of the Company's policies for Executive 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;
- ▶ 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 2017. The Annual Report on Remuneration is subject to an advisory shareholder vote at the AGM on Wednesday 23 May 2018.

Annual statement from the Chair of the Remuneration Committee

Remuneration outcomes for the year ended 31 December 2017

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 played a crucial role in the Committee's decision making during the year. 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 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
- ▶ remuneration rewards specific KPIs which deliver, inter alia, long-term value to shareholders, a safe operating environment, compliance with relevant health and safety policies and outstanding service to customers.

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

During the year, the Committee discussed the steps required to provide statutory information relating to the gender pay gap legislation.

External advice

- ▶ During the period, the Committee engaged FIT Remuneration Consultants to assist with benchmarking Executive Directors' and Non-executives Directors' remuneration and the redesign of the LTIP and CSOP scheme.

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
13 March 2018

Remuneration Committee continued**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 Wednesday 23 May 2018).

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.

In 2017 the Committee has undertaken a review of the long-term incentives on offer for Executive Directors and other senior members of staff which has led to the development of a Long Term Incentive Plan and CSOP intended for introduction during 2018.

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 2017 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.	<p>Salaries are typically reviewed annually, with any changes effective from 1 January. The review takes into account:</p> <ul style="list-style-type: none"> ▶ Company performance; ▶ the role, experience and performance of the individual Director; and ▶ average workforce salary adjustments within the Company. <p>Salaries are benchmarked from time to time against comparable roles at companies of a similar size and complexity.</p>	Increases normally for inflation and in line with other employees, or in order 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 2017 and there was no increase. On 1 January 2018 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.	<p>Reviewed from time to time to ensure that benefits when taken together with other elements of remuneration remain market competitive.</p> <p>The Company pays for private healthcare for each Executive Director and their immediate family.</p> <p>The Company provides a company car allowance for the CEO.</p> <p>The Executive Directors also currently participate in the Company's life assurance and income protection schemes.</p>	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

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 (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 2017, 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 Director to any project outside the ordinary course of the business with a particular emphasis on level of commitment made by the Executive Director.

We intend to launch a new Long Term Incentive Plan (LTIP) during the course of 2018. The Committee has taken advice from external specialist remuneration consultants in designing a scheme which we believe will ensure a clear and transparent alignment of interest between management and shareholders together with the longer-term retention and incentivisation of the Executives involved. We will report on this fully at the appropriate time.

Service contracts and policy on payment for loss of office

It is the Company's policy to provide for 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. During the year, £139,605 was payable to two Directors as settlements following resignation.

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.

Remuneration Committee continued

Annual report on remuneration

Directors' emoluments for the financial year ended 31 December 2017

	Fees/ basic salary £	Bonus £	Pension contribution £	Benefits in kind £	2017 Total £	2016 Total £
Executive						
A H Foy	340,000	263,500	1,433	15,551	620,484	526,631
G Murray ¹	24,543	—	1,227	2,240	28,010	167,510
D Harris ²	77,269	—	—	3,985	81,254	—
D Thompson ³	69,821	68,549	3,208	—	141,578	—
Non-executive						
W MacDiarmid ⁴	90,000	—	—	—	90,000	75,000
M Greenwood	45,000	—	—	—	45,000	45,000
G Bissett ⁵	45,000	—	—	—	45,000	26,250
P Dollman ⁶	—	—	—	—	—	36,577
Total	691,633	332,049	5,868	21,776	1,051,326	876,968

1 G Murray's remuneration for 2017 is to the date of resignation as a Director, 21 March 2017.

2 D Harris's remuneration for 2017 is from the date of appointment to date of resignation as a Director, 21 March 2017 to 4 August 2017.

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

4 W MacDiarmid's remuneration for 2016 reflects his appointment as Chairman, 26 May 2016.

5 G Bissett's remuneration for 2016 is from the date of appointment as a Non-executive Director, 1 June 2016.

6 P Dollman's remuneration for 2016 is to the date of resignation as Chairman 26 May 2016.

The pension contributions for Executive Directors in 2016 were £18,914.

Directors' interests

The Directors who held office at 31 December 2017 had the following interests in the shares of the Company:

	Ordinary shares	
	2017 £0.01 each	2016 £0.01 each
Executive		
A H Foy	7,180,608	7,180,608
D Thompson	—	—
Non-executive		
M Greenwood	16,172	14,650
W MacDiarmid ¹	5,923	—
G Bissett	5,300	—
	7,208,003	7,195,258

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					
G Murray ¹	Approved	35,974	76p	15/07/11	15/07/14
	Unapproved	166,667	60p	20/06/11	20/06/16
	Unapproved	28,700	60p	20/06/13	20/06/13
D Thompson	Unapproved	100,000	529p	01/09/16	01/09/21

1 G Murray's holding is at the date of his resignation as a Director, 21 March 2017; upon resignation these options were retained.

The share price at 31 December 2017 was 851.4p. The range in the period 1 January to 31 December 2017 was 483.25p to 851.4p.

Details of share options granted by the Company at 31 December 2017 are given in note 23.

Directors' report

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 2017.

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 2017 (on pages 2 to 26) which is incorporated by reference into this Directors' Report.

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 April 2016
A H Foy	Chief Executive Officer	24 December 2009
M Greenwood	Non-executive Director	3 February 2014
G Bissett	Non-executive Director	1 June 2016
D Thompson	Chief Financial Officer	11 September 2017

G Murray served as Chief Financial Officer until his resignation as a Director on 21 March 2017.

D Harris was appointed as Chief Financial Officer on 21 March 2017 and resigned on 4 August 2017.

K Olsen was appointed as Non-executive Director on 24 January 2018.

Political contributions

No political contributions were made during the year (2016: £Nil).

Substantial shareholdings

On 1 February 2018, 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
Old Mutual Asset Manager (UK)	13,989,747	12.44
Liontrust Asset Management	9,860,744	8.77
Mr Alan Foy	7,180,608	6.39
River & Mercantile Asset Management	6,537,609	5.81
Hargreave Hale	5,941,864	5.28
Mr Steve P Timoney	4,594,344	4.09
Standard Life Investments	4,526,642	4.03
Abdiel Capital Management LLC	4,534,120	4.03
Aberdeen Asset Management	3,341,765	2.97
Legal & General Investment Management	3,163,062	2.81

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 2017, the issued share capital of the Company was £1,124,508 comprising 112,450,800 ordinary shares of 0.01p each. As announced on 24 November 2017, there was an allotment of 21,739,131 shares pursuant to a placing of new shares in the Company.

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

Dividends

The Directors recommend the payment of a final dividend of 3.46p per ordinary share (2016: 2.73p), payable on 31 May 2018 to shareholders on the Company's Register of Members as at the close of business on 27 April 2018. The shares will be quoted as ex-dividend on 26 April 2018. This final dividend, together with the interim dividend of 1.74p per ordinary share (2016: 1.37p) paid on 24 November 2017, makes a total dividend of 5.20p per ordinary share for the 2017 financial year (2016: 4.10p).

Financial instruments

Details of the use of financial instruments and financial risk management are included in note 19 of the notes to the accounts contained in this Annual Report and Accounts 2017, which is incorporated by reference into this Directors' Report.

Directors' report continued

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.

SMS operates an Equal Opportunities policy, which is documented in the employee handbook. 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.

Research and development

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

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.

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
- ▶ the Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself 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.

Approved by the Board of Directors and signed on behalf of the Board.

David Thompson
Chief Financial Officer

13 March 2018

Directors' responsibilities statement

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 and enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006. 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.

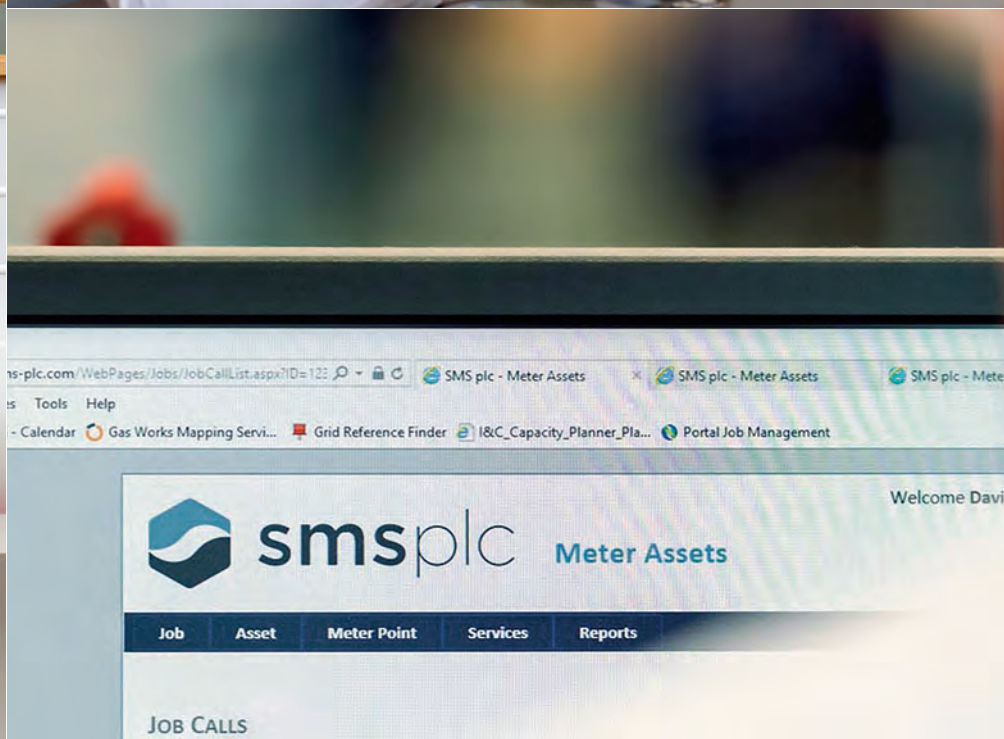
The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Smart Metering Systems plc website.

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



FINANCIAL STATEMENTS

- 45 Independent auditor's report
- 52 Consolidated statement of comprehensive income
- 53 Consolidated statement of financial position
- 54 Consolidated statement of changes in equity
- 55 Consolidated statement of cash flows
- 56 Accounting policies
- 62 Notes to the financial statements
- 78 Parent company balance sheet
- 79 Parent company statement of changes in equity
- 80 Notes to the parent company financial statements



Independent auditor's report

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 2017 and of the Group's profit for the year then ended;
- ▶ the Group financial statements have been properly prepared in accordance with IFRS's 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 2017	Balance sheet as at 31 December 2017
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 year then ended	Related notes 1 to 7 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 (IFRS's) 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, and FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

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

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

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.

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.

Independent auditor's report continued

To the members of Smart Metering Systems plc

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none"> ▶ Recoverability of termination income and the impact on traditional domestic meter assets residual values. ▶ Appropriateness of capitalisation of overheads and other expenses within domestic meter assets. ▶ Existence of smart meter inventory held by third parties.
Audit scope	<ul style="list-style-type: none"> ▶ We performed an audit of the complete financial information of three components and audit procedures on specific balances for a further three components. ▶ The components where we performed full or specific audit procedures accounted for 97% of pre-tax profit before exceptional items, 93% of revenue and 99% 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
<p>Recoverability of termination income within trade and other receivables (£25.7m, PY comparative £15.8m) and the impact on traditional domestic meter assets residual values</p> <p><i>Refer to the Audit Committee Report (page 33); accounting policies (page 56); and note 14 of the consolidated financial statements (page 69).</i></p> <p>At 31 December 2017 the Group carried total meter assets amounting to £262m (2016: £155m).</p> <p>The UK government target to replace all traditional domestic meters with smart meters means that traditional meters will be removed early. The current useful life of the Group's traditional domestic meters reflects management's assessment of the impact of the replacement programme on existing traditional meter assets.</p> <p>The deinstallation of traditional domestic meter assets whilst within their customer contract term gives rise to termination income designed to compensate the group for loss of future earnings and carrying value of the asset. Variances in contractual terms increase the complexity of assessing recoverability of termination income.</p> <p>The expected recoverability of termination income impacts the residual value of traditional domestic meters and amounts due on meters that have been removed.</p>	<p>We identified controls designed by management to assess the recoverability of termination income and its impact on the residual value of traditional domestic meter assets portfolio and ensured these had been implemented.</p> <p>We reperformed management's calculation of residual value and agreed the depreciation charge to a sample of depreciation rates for specific items with the fixed register. Specifically this included checking the clerical accuracy of the model and the integrity of source inputs.</p> <p>We evaluated the judgements applied by management to estimate the residual value. Specifically this included assessing the recoverability of termination fees and the impact on residual values.</p> <p>We assessed the recoverability of earned termination fees by:</p> <ul style="list-style-type: none"> ▶ Reviewing contractual agreements with key customers to assess management's judgement of recoverability. ▶ Inspecting evidence of payments received during and subsequent to the year end. Where payment was not received we inspected the latest correspondence between the Group and customers to assess recoverability. ▶ We obtained an understanding of changes in assumptions from the prior year. We inspected evidence of payment and correspondence from customers to evaluate management's assumptions. 	<p>Based on the audit procedures performed we assessed the estimate of the residual value, useful economic life and recoverability of termination income to be reasonable.</p> <p>We also consider there to be sufficient evidence to support management's expectation that termination income recognised is recoverable.</p>

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>The depreciation charge for meters is impacted by residual value and the expected remaining useful economic life of the meter.</p> <p>Significant judgement is applied by management to estimate the recoverability of the termination income and the expected useful economic life. Variations in contractual terms by customer increase the complexity in making these assessments.</p>	<p>We considered the appropriateness of the related disclosures in notes and application of accounting policies in the Group Financial Statements.</p> <p>We performed full and specific scope audit procedures over this risk area in one location, which covered 100% of the risk amount.</p>	
<p>Appropriateness of capitalisation of overheads and other expenses within the total additions capitalised within plant and machinery (£122.8m, PY comparative £42.5m)</p> <p><i>Refer to Audit Committee Report (page 33); accounting policies (page 56); and note 10 in the group financial statements.</i></p> <p>As at 31 December 2017 the Group carried total meter assets amounting to £262m (2016: £155m). This includes internal operational costs that have been capitalised in the current year.</p> <p>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 domestic smart meters under management.</p> <p>Since the acquisition of CH4 and Trojan a significant proportion of the Group's smart meters are fitted by its in-house engineering team.</p> <p>The significant risk relates to the appropriateness of the judgements made by management when assessing the appropriate categories and proportion of overheads and other expenses that are directly attributable to the installation of each domestic smart meter.</p>	<p>We identified controls designed by management to determine the categories and proportion of 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.</p> <p>We evaluated the judgement applied by management to assess the appropriate categories and proportion of overheads and other expenses that are directly attributable to installation of meter assets. This included:</p> <ul style="list-style-type: none"> ▶ Assessment of the capitalisation methodology applied ▶ Assessment of the key assumptions made by management, such as directly attributable headcount, directly attributable overheads, number of meter fits and engineer training requirements by obtaining supporting information <p>We benchmarked the average installation cost capitalised to contracted third-party installation costs to assess the reasonableness of amount capitalised.</p> <p>We performed full and specific scope audit procedures over this risk area in one location, which covered 100% of the risk amount.</p>	<p>Based on the results of our audit procedures, we consider the amounts capitalised for meters installed by in-house engineers to be reasonable.</p>

Independent auditor's report continued

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
Existence of smart meter inventory held by third parties <i>Refer to Audit Committee Report (page 33) and note 13 in the group financial statements (page 69).</i> As at 31 December 2017 the Group carried inventory amounting to £16.5m (2016: £6.1m). A proportion of inventory is managed by third parties at the year-end. To meet the increased demand for smart meter installations the Group has increased the level of installation inventory held and managed by two third parties at external warehouses, drop-boxes and engineers' vans. The Group is reliant on reporting from a single third-party installer of the levels of smart meter inventory held. The number of locations, systems and third parties responsible for managing the movement of inventory increases the risk of an error in the quantity of inventory reported to the Group. The significant risk relates to inventory existence arising from a misstatement in the quantity of inventory on hand reported to the group by the third-party installer.	We identified controls designed by management to assess the appropriateness of the levels of smart meter inventory held at third-party locations and ensured these had been implemented. We tested the controls over inventory by attending and obtaining results of perpetual inventory physical counts around year end and during the year at one third-party location holding a material quantity of inventory. We attended a full stock count at the other third-party location. We tested the Group's reconciliation of inventory managed by third party at the year end. Specifically this included obtaining an understanding of reconciling items and confirming quantities to source documentation including third-party confirmation. We performed cut off testing on inventory receipts and usage around the year end. 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 the procedures performed we conclude the smart meter inventory held by third parties exists and is owned by the Group.

In the prior year, our Auditor's Report did not report key audit matters.

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 eight reporting components of the Group, we selected six components covering entities, which represent the principal business units within the Group.

Of the six components selected, we performed an audit of the complete financial information of three components ("full scope components"), which were selected based on their size or risk characteristics. For the remaining three components ("specific scope components"), we performed audit procedures on specific accounts within that component 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.

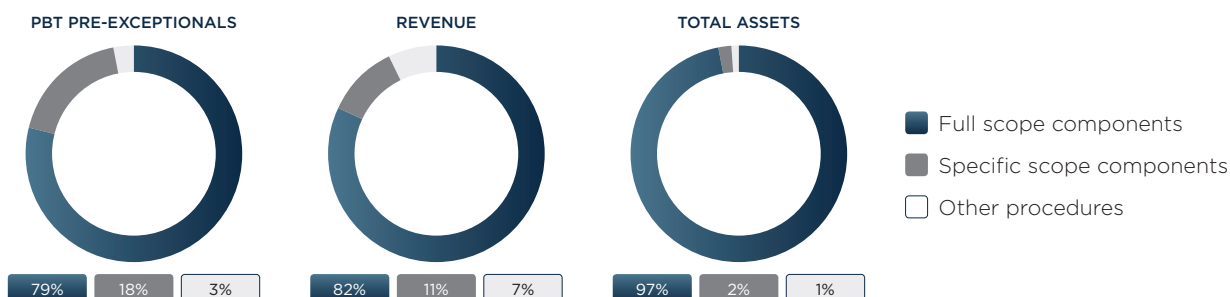
The reporting components where we performed audit procedures accounted for 97% (2016: 100%) of the Group's adjusted profit before tax (PBT) before exceptional items, 93% (2016: 100%) of the Group's revenue and 99% (2016: 99%) of the Group's total assets. For the current year, the full scope components contributed 79% (2016: 68%) of the Group's adjusted PBT before exceptional items, 82% (2016: 90%) of the Group's revenue and 97% (2016: 99%) of the Group's total assets. The specific scope component contributed 18% (2016: 32%) of the Group's adjusted PBT before exceptional items, 11% (2016: 10%) of the Group's revenue and 2% (2016: 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 3% of the Group's adjusted profit before tax and before exceptional items, none are individually greater than 5% of the Group's adjusted PBT 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.

An overview of the scope of our audit continued

Tailoring the scope continued

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



Changes from the prior year

The reduction in coverage from the prior year reflects the reduction in scope for two components of the Group from specific scope to review scope. This reflects the growth of the full scope locations and reorganisation of the business during the year.

Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit engagement team, or by component auditors from other EY global network firms operating under our instruction. 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 (2016: £0.9m), which is 5% (2016: 5%) of pre-tax profit before exceptional items (2016: pre-tax profit). We believe that pre-tax profits before exceptional items provides us with an appropriate materiality threshold for the users of the financial statements.

We determined materiality for the parent company to be £3.56m (2016: £0.5m), which is 2% (2016: 2%) of total equity.

Starting basis	PRE-TAX PROFITS - £18.0m BEING PRIMARY INDICATOR OF PERFORMANCE
Adjustments	EXCEPTIONAL COSTS - £2.0m NON-RECURRING COSTS NOT INCURRED IN NORMAL COURSE OF OPERATIONS
Materiality	TOTALS £20.0m (MATERIALITY BASIS) MATERIALITY OF £1.0m (5% OF MATERIALITY BASIS)

During the course of our audit, we reassessed initial materiality from forecast pre-tax profits to actual pre-tax profits after exceptional items which reduced our materiality by £0.1m.

Independent auditor's report continued

To the members of Smart Metering Systems plc

Our application of materiality continued

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% (2016: 50%) of our planning materiality, namely £0.5m (2016: £0.45m). We have set performance materiality at 50% based on 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 (2016: £0.09m to £0.37m).

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 (2016: £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 43, 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 light of the knowledge and understanding of the Group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

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

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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 43, 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 www.frc.org.uk/auditorsresponsibilities. This description forms part of our Auditor's Report.

Kevin Weston

(Senior statutory auditor)

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

13 March 2018

Notes:

- 1 The maintenance and integrity of the Smart Metering Systems plc 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 web site.
- 2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated statement of comprehensive income

For the year ended 31 December 2017

	Notes	2017 £'000	2016 £'000
Revenue	1	79,593	67,188
Cost of sales	2	(39,164)	(30,257)
Gross profit		40,429	36,931
Administrative expenses	2	(21,270)	(17,438)
Other operating income	2	3,446	1,075
Profit from operations	2	22,605	20,568
Attributable to:			
Operating profit before exceptional items, other operating income and amortisation of intangibles		22,825	21,939
Amortisation of intangibles		(2,151)	(1,991)
Other operating income		3,446	1,075
Exceptional items	2	(1,515)	(455)
Finance costs: exceptional	5	(524)	—
Finance costs: other	5	(4,137)	(2,327)
Finance income	5	21	2
Profit before taxation		17,965	18,243
Taxation	6	(3,306)	(2,998)
Profit for the year attributable to equity holders		14,659	15,245
Other comprehensive income		—	—
Total comprehensive income		14,659	15,245

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

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

	Notes	2017	2016
Basic earnings per share (pence)	7	16.17	17.33
Diluted earnings per share (pence)	7	15.89	17.02

Consolidated statement of financial position

As at 31 December 2017

	Notes	2017 £'000	2016 £'000
Assets			
Non-current assets			
Intangible assets	9	13,870	14,611
Property, plant and equipment	10	265,346	157,977
Investments	11	118	118
Trade and other receivables	14	594	628
		279,928	173,334
Current assets			
Inventories	13	16,575	6,121
Trade and other receivables	14	25,708	15,794
Cash and cash equivalents	15	150,600	7,999
		192,883	29,914
Total assets		472,811	203,248
Liabilities			
Current liabilities			
Trade and other payables	16	48,182	26,742
Bank loans and overdrafts	17	23,197	14,530
Commitments under hire purchase agreements	18	—	28
		71,379	41,300
Non-current liabilities			
Bank loans	17	163,887	87,646
Commitments under hire purchase agreements	18	—	1
Deferred tax liabilities	20	9,924	7,885
		173,811	95,532
Total liabilities		245,190	136,832
Net assets		227,621	66,416
Equity			
Share capital	22	1,124	892
Share premium		158,592	10,861
Other reserve	24	9,562	8,447
Treasury shares	23	(697)	(327)
Retained earnings		59,040	46,543
Total equity attributable to equity holders of the parent company		227,621	66,416

The financial statements on pages 52 to 77 were approved and authorised for issue by the Board of Directors and signed on its behalf by:

David Thompson

Director

13 March 2018

Company registration number

SC367563

Consolidated statement of changes in equity

For the year ended 31 December 2017

Attributable to the owners of the parent company:	Share capital £'000	Share premium £'000	Other reserve £'000	Treasury shares £'000	Retained earnings £'000	Total £'000
As at 1 January 2016	861	9,650	4,258	(231)	32,847	47,385
Total comprehensive income for the year	—	—	—	—	15,245	15,245
Transactions with owners in their capacity as owners						
Dividends (note 8)	—	—	—	—	(3,145)	(3,145)
Shares issued	31	1,211	4,189	—	—	5,431
Shares held by SIP	—	—	—	(96)	—	(96)
Share options	—	—	—	—	444	444
Income tax effect of share options	—	—	—	—	1,152	1,152
As at 31 December 2016	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	232	147,731	1,115	—	—	149,078
Shares held by SIP	—	—	—	(370)	70	(300)
Share options	—	—	—	—	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

See notes 23 and 24 for details of the treasury shares and other reserve. The movement in share premium is net of £4.0m of permissible costs in relation to the equity placing.

Consolidated statement of cash flows

For the year ended 31 December 2017

	2017 £'000	2016 £'000
Operating activities		
Profit before taxation	17,965	18,243
Finance costs	4,661	2,327
Finance income	(21)	(2)
Fair value movement on derivatives	—	(46)
Depreciation	14,061	9,977
Amortisation	2,151	1,991
Share-based payment expense	146	348
Movement in inventories	(10,454)	(4,773)
Movement in trade and other receivables	(9,300)	(2,646)
Movement in trade and other payables	22,031	6,330
Cash generated from operations	41,240	31,749
Taxation	(1,008)	(401)
Net cash generated from operations	40,232	31,348
Investing activities		
Payments to acquire property, plant and equipment	(123,864)	(42,904)
Disposal of property, plant and equipment	3,335	2,499
Payments to acquire intangible assets	(1,416)	(1,084)
Acquisition of subsidiary	—	(35)
Cash acquired with subsidiary	—	452
Finance income	21	2
Net cash used in investing activities	(121,924)	(41,070)
Financing activities		
New borrowings	104,075	30,442
Capital repaid	(19,167)	(12,845)
Hire purchase repayments	(29)	(1,028)
Finance costs	(4,521)	(2,646)
Net proceeds from share issue	147,963	1,232
Dividend paid	(4,028)	(3,145)
Net cash generated from financing activities	224,293	12,010
Net increase in cash and cash equivalents	142,601	2,288
Cash and cash equivalents at the beginning of the financial year	7,999	5,711
Cash and cash equivalents at the end of the financial year (note 15)	150,600	7,999

Reconciliation of net cash flow to movement in net debt

For the year ended 31 December 2017

	2017 £'000	2016 £'000
Increase in cash and cash equivalents	142,601	2,288
Cash outflow from movement in debt	(84,908)	(17,460)
Changes in net debt arising from cash flows	57,693	(15,172)
Net debt at beginning of year	(94,176)	(79,004)
Net debt at end of year	(36,483)	(94,176)

Accounting policies

The consolidated financial statements of the Group for the year ended 31 December 2017 were approved and authorised for issue in accordance with a resolution of the Directors on 13 March 2018. 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 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. The Group has committed bank facilities of £280m which extend to November 2020.

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 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 if 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, the costs of which are capitalised and depreciated as part of fixed asset 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; and
- ▶ recoverability of termination income and the impact on traditional domestic meter assets residual values:
 - ▶ the timing of the removal of traditional domestic meters during the smart meter rollout and the associated termination fees impact the residual value of these meters on subsequent disposal. Judgement is required around the expected pace of the smart meter replacement programme to ensure any gains or losses on disposal are minimised.

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.

Revenue recognition

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

Data 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.

Financial assets

Initial recognition and measurement

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. The Group determines the classification of its financial assets at initial recognition.

The Group's financial assets include cash and short-term deposits, trade and other receivables.

Financial liabilities

Initial recognition and measurement

Financial liabilities within the scope of IAS 39 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. All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

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

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.

Initial recognition and subsequent measurement

The Group has used derivative financial instruments, such as interest rate swaps, to hedge its interest rate risk. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. The Group has not designated any derivatives for hedge accounting.

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 nature or expected infrequency of the events giving rise to them, merit separate presentation to allow shareholders to understand better the elements of financial performance in that year, so as to facilitate comparison with prior periods and to assess better trends in financial performance. Termination fee income is reported as a separately disclosed item given the materiality and nature.

Accounting policies continued

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% 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 and its fair value can be measured reliably.

Intangible assets are amortised over their useful lives as follows:

- ▶ Software 12.5% and 20% straight line
- ▶ Customer contracts 20%

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 arising on consolidation represents the excess of the consideration transferred and 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 CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose identified according to its operating segment.

Provisional fair values are adjusted against goodwill if additional information is obtained within one year of the acquisition date about facts or circumstances existing at the acquisition date. Other changes in provisional fair values are recognised through profit or loss.

Changes in contingent consideration arising from additional information, obtained within one year of the acquisition date, about facts or circumstances that existed at the acquisition date are recognised as an adjustment to goodwill. Other changes in contingent consideration are recognised through profit or loss, unless the contingent consideration is classified as equity. In such circumstances, changes are recognised within equity.

Impairment

At each reporting date, the Group reviews the carrying amounts of its property, plant and equipment and intangibles to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax 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.

Impairment continued

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 tests with regard to discount, growth and inflation rates are set out in note 12 to the accounts.

Property, plant and equipment

Property, plant and equipment is stated at cost, net of accumulated depreciation and/or accumulated impairment losses, if any. Such cost includes the cost of replacing part of the 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 (see note 27) 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 useable condition.

All other repair and maintenance costs are recognised in the Consolidated statement of comprehensive income as incurred.

Depreciation is calculated on a straight line basis over the estimated useful life of the asset as follows:

- ▶ Freehold property 2% on cost
- ▶ Short leasehold property Shorter of the lease term or 15% and 20% on cost
- ▶ Plant and machinery 5%, 10% and 20% on cost
- ▶ Fixtures, fittings and equipment 15% and 33% on cost
- ▶ Motor vehicles 25% on cost
- ▶ Land is not depreciated.

During 2016, the Directors reassessed the useful life of domestic meters that were due to be replaced before the end of their useful life as part of the smart meter rollout programme. An exercise was undertaken to identify all meters affected and their useful life was shortened from 20 years to 5 years. In addition, the receipt of termination income under certain circumstances when meter rental assets are removed before the end of their useful life was also reflected in a revision to residual values. These factors resulted in a net increase to the overall depreciation charge of £685,000 in 2016.

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.

Inventories

Inventories are stated at the lower of cost and net realisable value. Costs comprises direct materials. 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.

Hire purchase agreements

Assets held under hire purchase agreements are capitalised and disclosed under property, plant and equipment at their fair value. The capital element of the future payments is treated as a liability and the notional interest is charged to the Consolidated statement of comprehensive income in proportion to the remaining balance outstanding.

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.

Accounting policies continued

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. Own shares held under trust for the Group's employee share schemes are classed as treasury shares and deducted in arriving at shareholders' equity. Purchases of own shares are disclosed as changes in shareholders' equity.

Taxation

Tax currently payable is based on the taxable profit for the year. 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 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 liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. The deferred tax balance is calculated based on tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax assets include temporary differences related to employee benefits settled via the issue of share options. Recognition of the deferred tax assets assumes share options will have a positive value at the date of vesting, which is greater than the exercise price.

Standards and interpretations

These new accounting standards and amendments are applicable to the Group for the first time in 2017. However, they do not impact the annual consolidated financial statements of the Group. These are:

Standard or interpretation		Periods commencing on or after
Amendment to IAS 12	Recognition of Deferred Tax Assets for Unrealised Losses	1 January 2017
Amendments to IAS 7	Disclosure Initiative	1 January 2017
Standard or interpretation		Periods commencing on or after
IFRS 15	Revenue from Contracts with Customers	1 January 2018
Clarifications to IFRS 15	Revenue from Contracts with Customers	1 January 2018
IFRS 9	Financial Instruments	1 January 2018
IFRS 16	Leases	1 January 2019
Amendments to IFRS 2	Classifications and Measurement of Share-based Payment Transactions	1 January 2018
Annual Improvements to IFRSs	2014-2016 Cycle	1 January 2018
IFRIC Interpretation 22	Foreign Currency Transactions and Advance Consideration	1 January 2018 ¹

¹ Not yet adopted for use in the European Union.

The above standards and interpretations will be adopted in accordance with their effective dates and have not been adopted in these financial statements.

Standards and interpretations continued

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 15

An impact assessment has been performed on new standard IFRS 15 Revenue from Contracts with Customers (IFRS 15) which SMS plc will adopt from 1 January 2018. IFRS 15 introduces a five-step approach to the timing of revenue recognition based on the delivery of performance obligations and an assessment of when control is transferred. This differs from existing IAS 11/18 which focuses on the transfer of "risk and reward" as the point of recognition. The Group will adopt the modified retrospective method where the cumulative effect of initially applying the standard is recognised as an adjustment to the opening balance sheet in the period of initial application.

Scoping of our revenue streams has been considered as follows:

- ▶ Asset management (meter rental): This makes up around 50% of total SMS revenue; rental income from suppliers is recognised as revenue based on operating lease accounting and therefore falls in scope for IFRS 16 and is discussed below.
- ▶ Asset management (data): This involves the provision of data recording and transmission services from meters to supplier. Revenue is recognised straight line over the period of the contract. All data revenue is in scope for IFRS 15.
- ▶ Asset installations: Transactional revenue is billed to the customer on completion of the installation – which is when "control" passes and revenue is recognised. This segment also includes connections revenue which is a subset of installations but includes some longer-term projects. All installations revenue is in scope for IFRS 15.
- ▶ Energy services: The Provision of energy advice which is specific to the customer; revenue is recognised on a transactional basis when "control" is transferred and is fully in scope for IFRS 15.

For revenue which is in scope for IFRS 15, a review has been carried out on existing customer contracts. Within SMS plc no existing contracts have been identified where more than one performance obligation exists. The majority of revenue comes from the simple installation of a meter asset, where there is only one performance obligation and control is deemed to transfer at the same point in time as risk and reward previously. Occasionally, SMS plc also engages in some longer-term contracts which fall under connections revenue within the asset installation business – SMS connections accounts for approximately 7% of Group revenue and only a small proportion of this comprise longer-term contracts. In such longer-term instances there may be various elements or stages to the contracts; however, these elements are not deemed to be "distinct" as defined by the standard and therefore only one performance obligation is considered to exist in such instances too. Our assessment concludes that no impact is expected when transitioning to IFRS 15.

IFRS 16

SMS plc will adopt IFRS 16 Leases (IFRS 16) on 1 January 2019, as such a full impact assessment has been carried out. All meter rental revenue within the meter assets business is treated as an operating lease with SMS plc as the lessor and is therefore in scope for IFRS 16. As a lessor, the new standard does not make any significant changes to the way leases are accounted for currently under IAS 17 but it does provide additional guidance on what is defined as a lease. With regards to the definition of leases, SMS plc will continue to treat existing leases as operating leases and "grandfather" this assessment into the new standard. Any new contracts entered into following 1 January 2019 will be considered on their own merits under IFRS 16; however, all meter rental revenue is expected to continue to be classified as a lease and as such the new standard is not expected to have any impact on the way SMS plc accounts for its meter rental revenue.

SMS plc also holds some operating leases for buildings and office equipment as the lessee. Under IFRS 16, a lease liability will have to be recognised on the balance sheet for each and they will be depreciated over the period of the lease. Please refer to note 25 for details on the Group's operating lease commitments.

IFRS 9

Ahead of the adoption of IFRS 9 Financial Instruments (IFRS 9) on 1 January 2018, management has reviewed the impact of the standard to ensure compliance with the new standard. Management expects the impact on accounting for loan modifications and the unlisted investment to be minimal, and the expected credit loss model for impairment review will not have an overall impact on the Group. The expected credit loss approach may impact the individual retained earnings of individual entities within the Group due to potential additional impairment provision for long-term intercompany receivables. These potential impairments would not impact the Group as they would be intra-Group items.

Notes to the financial statements

For the year ended 31 December 2017

1 Segmental reporting

For management purposes, the Group is organised into three core divisions, asset management, asset installation and energy management, which form the basis of the Group's reportable operating segments, and operating segments within those divisions are combined on the basis of their similar long-term economic characteristics and similar nature of their products and services, as follows:

- ▶ Asset management comprises regulated management of gas meters, electric meters and ADM™ units within the UK.
- ▶ Asset installation comprises installation of domestic and I&C gas meters and electricity meters throughout the UK.
- ▶ Energy management comprises the provision of energy advice.

Management monitors the operating results of its divisions separately for the purpose of making decisions about resource allocation and performance assessment. The operating segments disclosed in the financial statements are the same as reported to the Board. Segment performance is evaluated based on gross profit.

At the most granular level of information presented to the CODM, asset management aggregates four operating segments (gas meter rental, electricity meter rental, gas data and electricity data) principally on the basis that they derive from the same asset using similar processes for consistent customers and are often provided together. Asset installation aggregates two operating segments (gas transactional and electricity transactional) due to the consistent nature of the services, customers and delivery processes.

The following segment information is presented in respect of the Group's reportable segments together with additional balance sheet information:

31 December 2017	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
Segment/Group revenue	48,655	27,517	3,421	—	79,593
Cost of sales	(18,958)	(17,970)	(2,236)	—	(39,164)
Segment profit – Group gross profit	29,697	9,547	1,185	—	40,429
Items not reported by segment					
Other operating costs/income	—	—	—	(13,465)	(13,465)
Depreciation	—	(24)	—	(669)	(693)
Amortisation	(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

31 December 2016	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
Segment/Group revenue	37,359	26,115	3,714	—	67,188
Cost of sales	(14,441)	(13,735)	(2,081)	—	(30,257)
Segment profit – Group gross profit	22,918	12,380	1,633	—	36,931
Items not reported by segment					
Other operating costs/income	—	—	—	(13,174)	(13,174)
Depreciation	—	(22)	—	(721)	(743)
Amortisation	(1,991)	—	—	—	(1,991)
Exceptional items	—	—	—	(455)	(455)
Profit from operations	20,927	12,358	1,633	(14,350)	20,568
Net finance costs	(2,325)	—	—	—	(2,325)
Profit before tax	18,602	12,358	1,633	(14,350)	18,243
Tax expense					(2,998)
Profit for year					15,245

1 Segmental reporting continued

Depreciation 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:

	2017 £'000	2016 £'000
Customer 1 – asset management	10,175	10,752
Customer 1 – asset installation	3,541	4,991
	13,716	15,743

Segment assets and liabilities

	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
31 December 2017					
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
	288,421	4,158	109	3,103	295,791
Assets not by segment					177,020
Total assets					472,811
Liabilities by segment					
Bank loans	187,084	—	—	—	187,084
	187,084	—	—	—	187,084
Liabilities not by segment					58,106
Total liabilities					245,190
31 December 2016					
Assets reported by segment					
Intangible assets	11,114	3,497	—	—	14,611
Property, plant and equipment	155,131	66	—	2,780	157,977
Inventories	5,569	446	106	—	6,121
	171,814	4,009	106	2,780	178,709
Assets not by segment					24,539
Total assets					203,248
Liabilities by segment					
Bank loans	102,176	—	—	—	102,176
Obligations under hire purchase agreements	—	29	—	—	29
	102,176	29	—	—	102,205
Liabilities not by segment					34,627
Total liabilities					136,832

Notes to the financial statements continued

For the year ended 31 December 2017

2 Income statement by nature and items of expenditure included in the Consolidated statement of comprehensive income

	2017 £'000	2016 £'000
Revenue	79,593	67,188
Direct rental costs	(5,408)	(4,684)
Direct subcontractor costs	(4,667)	(4,054)
Other direct sales costs and systems rental	(14,360)	(11,429)
Stock expense	(1,360)	(855)
Staff costs	(14,400)	(9,710)
Depreciation:		
– owned assets	(14,044)	(9,898)
– leased assets	(17)	(79)
Amortisation	(2,151)	(1,991)
Other operating income	3,446	1,075
Auditor's remuneration:		
– as auditor	(202)	(136)
– audit related assurance services	(59)	(9)
Exceptional costs	(1,515)	(455)
Operating lease rentals	(1,621)	(1,152)
Other operating charges	(630)	(3,242)
Profit from operations	22,605	20,568
Finance costs: exceptional	(524)	—
Finance costs: other	(4,137)	(2,327)
Finance income	21	2
Profit before taxation	17,965	18,243

Included in exceptional items are £300,000 (2016: £Nil) of refinance costs and £1,215,000 (2016: £Nil) of redundancy, other personnel, and property dilapidations costs relating to the reorganisation of subsidiaries acquired in the prior year. Included within depreciation – owned assets is £13,368,000 (2016: £9,235,000) of depreciation that has been allocated and reported in cost of sales. Exceptional finance costs of £524,000 relate to the refinancing.

Auditor's remuneration can be analysed as:

	2017 £'000	2016 £'000
Statutory Group audit	202	136
Other services – audit related assurance services	59	9
	261	145

3 Particulars of employees

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

	2017 Number	2016 Number
Number of administrative staff	188	100
Number of operational staff	563	580
Number of sales staff	3	2
Number of IT staff	35	30
Number of Directors	2	2
	791	714

3 Particulars of employees continued

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

	2017 £'000	2016 £'000
Wages and salaries	26,615	18,880
Social security costs	2,754	1,895
Staff pension costs	400	240
Share-based payment	446	444
Director pension costs	9	19
	30,224	21,478

4 Directors' emoluments

The Directors' aggregate remuneration in respect of qualifying services were:

	2017 £'000	2016 £'000
Emoluments receivable	1,046	858
Value of Group pension contributions to money purchase schemes	4	6
Other pension	1	13
	1,051	877

During the year, £139,605 was payable to two Directors as settlements following resignation.

During the year, no Directors exercised share options (2016: One Director exercised 500,000 unapproved share options, resulting in a gain of £1,725,000). Please refer to pages 36 to 40 for details of Directors' remuneration.

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

	2017 £'000	2016 £'000
Emoluments of highest paid Director		
Total emoluments	619	513
Pension contributions	1	13
	620	526

The number of Directors who accrued benefits under Company pension schemes was as follows:

	2017 Number	2016 Number
Money purchase schemes	2	2

5 Finance costs and finance income

	2017 £'000	2016 £'000
Finance costs		
Bank loans and overdrafts	4,134	2,323
Interest rate hedge fair value	—	(46)
Hire purchase	3	50
Exceptional finance costs	524	—
Total finance costs	4,661	2,327
Finance income		
Bank interest receivable	21	2
Total finance income	21	2

Notes to the financial statements continued

For the year ended 31 December 2017

6 Taxation

	2017 £'000	2016 £'000
Analysis of charge in the year		
Current tax:		
Current income tax expense	971	1,362
Adjustment to tax charge in respect of previous periods	(83)	450
Total current income tax	888	1,812
Deferred tax:		
Origination and reversal of temporary differences	2,705	1,514
Adjustment to tax charge in respect of prior periods	(287)	(328)
Tax on profit	3,306	2,998

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

Profit before tax	17,965	18,243
Tax at the UK corporation tax rate of 19.25% (2016: 20.00%)	3,458	3,649
Expenses not deductible for tax purposes	(7)	11
Deferred tax not recognised	2	—
Adjustments to tax charge in respect of previous periods	140	123
Change in tax rate	(287)	(785)
Tax expense in the income statement	3,306	2,998

Current tax credit through equity in the year was £0.97m (2016: £1.25m).

7 Earnings per share (EPS)

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

	2017 £'000	2016 £'000 restated
Profit for the year used for calculation of basic EPS	14,659	15,245
Amortisation of intangible assets	2,151	1,991
Exceptional costs	2,039	455
Tax effect of adjustments	(780)	(401)
Earnings for the purpose of adjusted EPS	18,069	17,290
Number of shares	2017	2016
Weighted average number of ordinary shares for the purposes of basic EPS	90,655,868	87,955,744
Effect of potentially dilutive ordinary shares:		
– share options	1,615,280	1,604,623
Weighted average number of ordinary shares for the purposes of diluted EPS	92,271,148	89,560,367
EPS:		
– basic (pence)	16.17	17.33
– diluted (pence)	15.89	17.02
Adjusted EPS:		
– basic (pence)	19.93	19.66
– diluted (pence)	19.58	19.31

The Directors consider that the adjusted EPS calculation gives a better understanding of the Group's EPS as the adjusted earnings basis better reflects the Group's underlying sustainable business performance.

The 2016 EPS figures have been restated to reflect the Board's decision to change the presentation of the underlying performance measures to include other operating income.

8 Dividends

	2017 £'000	2016 £'000
Equity dividends		
Paid during the year:		
Interim paid in respect of 2017, 1.74p per share	1,576	—
Final paid in respect of 2016, 2.73p per share	2,452	—
Interim paid in respect of 2016, 1.37p per share	—	1,226
Final paid in respect of 2015, 2.20p per share	—	1,919
Total dividends	4,028	3,145

A final dividend of 3.46p per share for the year ended 31 December 2017 has been proposed and is due to be paid in May 2018.

9 Intangible assets

	Goodwill £'000	Customer contracts £'000	Development £'000	Software £'000	Total £'000
Cost					
As at 1 January 2016	4,112	2,160	2,073	5,281	13,626
Additions	—	—	454	630	1,084
Additions from acquisitions	3,497	6	—	2,000	5,503
Disposals	—	—	(13)	—	(13)
As at 31 December 2016	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
Amortisation					
As at 1 January 2016	—	998	242	2,358	3,598
Charge for year	—	432	228	1,331	1,991
As at 31 December 2016	—	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
Net book value					
As at 31 December 2017	7,609	565	2,091	3,605	13,870
As at 31 December 2016	7,609	736	2,044	4,222	14,611
As at 1 January 2016	4,112	1,162	1,831	2,923	10,028

Notes to the financial statements continued

For the year ended 31 December 2017

10 Property, plant and equipment

	Freehold/ leasehold property £'000	Plant and machinery £'000	Fixtures, fittings and equipment £'000	Motor vehicles £'000	Total £'000
Cost					
As at 1 January 2016	2,144	139,616	1,418	80	143,258
Additions	20	42,503	381	—	42,904
Additions from acquisitions	75	69	309	1,384	1,837
Disposals	—	(1,479)	—	(1,295)	(2,774)
As at 31 December 2016	2,239	180,709	2,108	169	185,225
Additions	61	122,782	1,020	1	123,864
Disposals	—	(3,359)	(63)	(87)	(3,509)
As at 31 December 2017	2,300	300,132	3,065	83	305,580
Depreciation					
As at 1 January 2016	170	16,499	832	57	17,558
Charge for year	93	9,235	508	141	9,977
Disposals	—	(217)	—	(70)	(287)
As at 31 December 2016	263	25,517	1,340	128	27,248
Charge for year	129	13,368	540	24	14,061
Disposals	—	(994)	(12)	(69)	(1,075)
As at 31 December 2017	392	37,891	1,868	83	40,234
Net book value					
As at 31 December 2017	1,908	262,241	1,197	—	265,346
As at 31 December 2016	1,976	155,192	768	41	157,977
As at 1 January 2016	1,974	123,117	586	23	125,700

The assets are secured by a bond and floating charge (note 17).

Hire purchase agreements

Included within the net book value of £265,346,000 (2016: £157,977,000) is £Nil (2016: £16,839) relating to assets held under hire purchase agreements. The depreciation charged to the consolidated financial statements in the year in respect of such assets amounted to £16,389 (2016: £79,578).

11 Financial asset investments

	Shares in Group undertaking £'000	Unlisted investments £'000	Total £'000
Cost			
As at 1 January and 31 December 2017	43	75	118

Shares in Group undertakings are not consolidated on the basis that they are 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. The goodwill is allocated to the asset management and asset installation segments, which are the segments that are expected to benefit from combining gas and electricity offerings. The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. The annual impairment test was performed and no evidence of impairment was found as at the balance sheet date.

Goodwill has been tested for impairment by comparing the carrying amount of each CGU, including goodwill, with the recoverable amount. The recoverable amounts are determined from value-in-use calculations.

12 Impairment of goodwill continued

The key assumptions for the value-in-use calculations are those regarding pre-tax cash flow projections, discount rates and growth rates. The pre-tax cash flow is based on past performance and expectations as set out in the latest projections based on financial budgets approved by management. This discount rate reflects the current market assessment of the time value of money. Long-term growth is assumed at 2% and the estimated cash flows are derived by discounting future cash flows that are based on conservative growth and attrition rates and discounted at a pre-tax rate of 8.2%.

Base case forecasts show significant headroom above the carrying value of each CGU; there is no reasonably possible change that would cause the carrying values to exceed recoverable amounts.

13 Inventories

	2017 £'000	2016 £'000
Finished goods	16,049	5,569
Consumables	526	552
	16,575	6,121

14 Trade and other receivables

	2017 £'000	2016 £'000
Trade receivables	10,959	7,610
Prepayments	1,421	1,369
Accrued income	9,812	5,248
Other receivables	1,263	617
VAT recoverable	1,827	892
Income tax recoverable	426	58
	25,708	15,794

Amounts falling due after more than one year:

	2017 £'000	2016 £'000
Accrued income	594	628

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 allowances for doubtful receivables. The allowance for doubtful receivables in the year was £1,812,000 (2016: £1,082,000). The ageing profile of trade receivables past due date is shown below:

	2017 £'000	2016 £'000
31-60 days	2,572	1,039
61-90 days	114	391
Over 90 days	3,055	1,883
	5,741	3,313
Allowance for doubtful receivables	(1,812)	(1,082)
	3,929	2,231

Trade receivables are non-interest bearing and are generally on 30-90-day terms.

Trade receivables due from related parties at 31 December 2017 amounted to £Nil (2016: £Nil).

Receivables are all in Sterling denominations.

The Directors are of the opinion that £1,812,000 of the overdue debts as at 31 December 2017 require impairment.

Accrued income is presented net of allowances for provisions, with accrued income being invoiced periodically and customers being the same as those within trade receivables.

Notes to the financial statements continued

For the year ended 31 December 2017

15 Cash and cash equivalents

Cash and cash equivalents comprises 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:

	2017 £'000	2016 £'000
Cash	150,600	7,999
	150,600	7,999

16 Trade and other payables

	2017 £'000	2016 £'000
Current		
Trade payables	23,923	11,421
Other payables	1,396	2,913
Advance payments	2,032	2,700
Other taxes	2,718	1,782
Deferred income	2,311	790
Accruals	15,802	6,411
Income tax payable	—	725
	48,182	26,742

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

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

All trade liabilities are Sterling denominated.

17 Bank loans and overdrafts

	2017 £'000	2016 £'000
Current		
Bank loans	23,197	14,530
	23,197	14,530
Non-current		
Bank loans	163,887	87,646
	163,887	87,646

Bank loans at 31 December 2017 relate to a revolving credit facility of £280m. In November 2017, SMS plc 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 results in £0.5m of finance costs that have been expensed through the profit and loss as exceptional.

The loan is available for 36 months and is payable in equal quarterly instalments based on a ten-year repayment profile, with final repayment due in November 2020. 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.

18 Commitments under hire purchase agreements

Future minimal commitments under hire purchase agreements are as follows:

	2017 £'000	2016 £'000
Current		
Amounts payable within one year	—	28
Non-current		
Amounts payable between two and five years	—	1

The Group no longer holds any hire purchase commitments. In 2016, the Group held hire purchase contracts for various items of computer equipment.

19 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 arises as a result of both its long and short-term borrowing facilities.

The Group seeks to manage exposure to interest rate fluctuations through the use of fixed interest rate swaps.

Interest rate sensitivity

The following table demonstrates the sensitivity to a change in interest rates on loans and borrowings after the impact of hedge accounting. The Group's profit before tax is affected through the impact on floating rate borrowings as follows:

Pounds Sterling	Increase/decrease in basis points	Effect on profit before tax £'000
2017	+70bps	(741)
2016	—	46

The Group can fix its variable rate borrowings for an additional premium of 70bps and we accordingly show the annual impact on our profit before tax. As mentioned in note 28 we have repaid £100m of the debt on 28 February 2018.

Interest rate risk profile of financial liabilities

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

	Fixed rate financial liabilities £'000	Variable rate financial liabilities £'000	Total £'000
2017	—	206,568	206,568
2016	—	112,796	112,796
1 January 2016	26,400	58,556	84,956

The fixed rate financial liabilities present at the start of 2016 related to the portion of the banking facility that was fixed through hedging instruments.

Interest rate risk profile of financial assets

The Group's financial assets at 31 December 2017 comprise cash and trade receivables. The cash balance of £150,600,000 (2016: £7,999,000) is a floating rate financial asset.

Fair values of financial liabilities and financial assets

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.

Notes to the financial statements continued

For the year ended 31 December 2017

19 Financial risk management continued**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 this criteria.

The ageing and maturity profile of the Group's material liabilities is covered within the relevant liability note or below.

	2017 £'000	2016 £'000
Variable rate		
Less than one year	27,500	16,574
Two to five years	104,664	62,792
Over five years	74,404	33,430
	206,568	112,796

Credit risk

Credit risk with respect to trade receivables and accrued income is due to the Group trading with a limited number of companies which are generally large utility companies or financial institutions. Therefore, the Group does not expect, in the normal course of events, that these debts are at significant risk. The Group's maximum exposure to credit risk equates to the carrying value of cash held on deposit and trade, other receivables and accrued income.

The Group's maximum exposure to credit risk from its customers is £20,771,000 (2016: £12,858,000) as disclosed in note 14 – trade receivables and accrued income.

The Group regularly monitors and updates its cash flow forecasts to ensure it has sufficient and appropriate funds to meet its ongoing operational requirements whilst maintaining adequate headroom on its facilities to ensure no breach in its banking covenants.

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.

20 Deferred taxation

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

	2017 £'000	2016 £'000
Opening deferred tax liability	7,885	6,139
Increase in provision through Consolidated statement of comprehensive income	2,418	1,186
Increase in provision through equity	(379)	98
Deferred tax on intangibles acquired as part of acquisitions	—	462
Closing deferred tax liability	9,924	7,885

All movements identified have gone through the Consolidated statement of comprehensive income.

20 Deferred taxation continued

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

	2017 £'000	2016 £'000
Excess of taxation allowances over depreciation on property, plant and equipment	11,559	8,934
Tax losses available	(61)	(265)
Deferred tax asset on share options	(1,998)	(1,643)
Deferred tax on intangible acquired	427	679
Other	(3)	180
	9,924	7,885

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

	2017 £'000	2016 £'000
Accelerated capital allowances	2,431	1,690
Tax losses	204	(175)
Deferred tax asset on share options	22	(33)
Movement in fair value of intangibles	(252)	(491)
Movement in fair value of interest rate swaps	—	10
Other	13	184
	2,418	1,185

The Finance Bill 2016, which was substantively enacted on 15 September 2016, included legislation reducing the main rate of UK corporation tax from 20% to 17%. This decrease is being phased in with the reduction to 19% effective from 1 April 2017, and a further reduction to 17% effective from 1 April 2020. Consequently deferred tax has been provided at the tax rates at which temporary differences are expected to reverse.

21 Related party transactions

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:

During the year the Group paid rent amounting to £49,800 (2016: £41,500) 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 £8,300 (2016: £4,150) was outstanding in this regard.

The Group also paid rent of £Nil (2016: £28,417) to another individual classified as key management for the use of certain premises.

During the year, the Group paid dividends to Alan Foy of £320,973 (2016: £269,548), Miriam Greenwood of £723 (2016: £421), Willie MacDiarmid¹ of £265 (2016: £Nil) and Graeme Bissett of £237 (2016: £Nil). At the year end Trojan Utilities Limited had a balance with Utilities Academy Limited of £26,442 (2016: £26,442) with transactions during the year amounting to £3,165 (2016: £49,508).

Remuneration of key management, which includes Executive and Non-executive Directors together with certain management personnel, was as follows:

	2017 £'000	2016 £'000
Salaries and other short-term employee benefits	2,073	1,622

¹ Paid to a connected person.

Notes to the financial statements continued

For the year ended 31 December 2017

22 Share capital

	2017 £'000	2016 £'000
Allotted and called up:		
112,450,800 ordinary shares of £0.01 each (2016: 89,203,739 ordinary shares of £0.01 each)	1,124	892

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 net proceeds of the placing are to be utilised alongside the extended debt facility to give SMS plc the financial and operational flexibility to fully fund the installation of approximately 2.5 million meters.

During the year 1,222,563 (2016: 2,018,772) ordinary share options were exercised in relation to the Group's employee share plans which are described in note 23. The ordinary shares issued have a nominal value of £12,226 (2016: £20,188), and aggregate consideration of £1,985,487 (2016: £1,231,617) was received.

On 5 April 2016 and on 15 September 2016, 1,072,055 ordinary shares and 285,367 ordinary shares were issued respectively as consideration for the acquisition of CH4 Gas Utility and Maintenance Services Limited ("CH4"), Trojan Utilities Limited ("Trojan") and Qton Solutions Limited ("Qton").

23 Share-based payments

On 20 June 2011, the Company adopted both an Approved Company Share Option Plan (CSOP) and an Unapproved Company Share Option Plan ("the Unapproved Plan").

CSOP

The CSOP is open to any employee of any member of the Group up to a maximum value of £30,000 per employee. No option can be exercised within three years of its date of grant. The performance conditions for awards are based on market capitalisation and individual performance targets.

Unapproved Plan

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 his time to his duties under his contract of employment. Except in certain specified circumstances no option will be exercisable within five years of its grant. The performance conditions for awards are based on market capitalisation and individual performance targets. The options granted on 28 June 2013 were granted following the surrender of previously vested awards held by the Non-executive Directors and became exercisable immediately on the date of grant.

Plan	At 1 January 2017	Granted	Exercised	Lapsed	At 31 December 2017	Exercise price (pence)	Date exercisable	Expiry date
CSOP	86,127	—	(57,674)	—	28,453	76.0	15/07/14	15/07/21
Unapproved	589,666	—	(268,000)	—	321,666	60.0	20/06/16	20/06/21
Unapproved	1,101,189	—	(651,189)	—	450,000	153.5	28/05/17	28/05/22
Unapproved	28,700	—	(28,700)	—	—	60.0	28/06/13	28/06/23
Unapproved	1,301,070	—	(217,000)	(301,785)	782,285	350.0	12/11/19	12/11/24
Unapproved	317,382	—	—	(18,033)	299,349	391.8	20/03/21	19/03/26
Unapproved	36,586	—	—	—	36,586	410.0	04/07/21	03/07/26
Unapproved	172,634	—	—	(14,630)	158,004	470.0	18/08/21	17/08/26
Unapproved	100,000	—	—	—	100,000	529.0	01/09/21	31/08/26
Unapproved	50,000	—	—	—	50,000	529.0	26/09/21	25/09/26

The average weighted average share price at the date of exercise was £6.20.

23 Share-based payments continued

Valuation

The fair value of all options granted has been estimated using appropriate option pricing models, taking into account the terms upon which the options were granted, including the market-based performance conditions. The fair value per share of the outstanding options were estimated as follows:

Grant date	Plan	Fair value (pence)
15 July 2011	CSOP	17.1
20 June 2011	Unapproved	13.0
28 May 2012	Unapproved	40.0
28 June 2013	Unapproved	244.0
12 November 2014	Unapproved	84.8
20 March 2016	Unapproved	61.5
4 July 2016	Unapproved	114.3
18 August 2016	Unapproved	87.2
1 September 2016	Unapproved	141.5
26 September 2016	Unapproved	142.4

The total fair value of these options is recognised over the period from their grant date until they become exercisable.

Share Incentive Plan (SIP)

The Company introduced the Smart Metering Systems Share Incentive Plan (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.

SIP awards

The table below shows the number of shares held in the SIP at the beginning and end of the financial year:

Type of award	At 1 January 2017	Awarded shares	Sold	Lapsed	At 31 December 2017	Weighted average acquisition price
Partnership	94,107	43,849	(13,628)	—	124,328	£4.79
Matching	93,707	43,849	(4,632)	(6,264)	126,660	£4.79
Dividend	1,497	1,419	(154)	—	2,762	£5.22
Total	189,311	89,117	(18,414)	(6,264)	253,750	

24 Other reserve

This is a non-distributable reserve that initially arose by applying merger relief under section 162 of the Companies Act 2006 to the shares issued in 2009 in connection with the Group restructuring. This was previously recognised as a merger reserve under UK GAAP. Under IFRS, this has been classed as an "other reserve". Additionally, the premium of £4,189,000 and £1,115,000 arising on the issue of shares as part of the acquisitions of CH4 Gas Utility and Maintenance Services Limited ("CH4"), Trojan Utilities Limited ("Trojan") and Qton Solutions Limited ("Qton") has been credited to this reserve.

25 Commitments under operating leases

The Group has entered into commercial leases for 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:

	2017 £'000	2016 £'000
Future minimal commitments under operating lease agreements are as follows:		
Payable within one year	1,262	1,543
Payable within two and five years	1,884	2,144
Payable after five years	477	162
	3,623	3,849

Notes to the financial statements continued

For the year ended 31 December 2017

26 Ultimate controlling party

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

27 Business combinations**Acquisitions of Trojan, CH4 and Qton**

On 18 March 2016, the Group acquired 100% of the issued share capital of CH4 Gas Utility and Maintenance Services Limited ("CH4"), 100% of the issued share capital of Trojan Utilities Limited ("Trojan") and 100% of the issued share capital of Qton Solutions Limited ("Qton").

CH4 and Trojan are meter suppliers and they enhance SMS's capability to be a key participant in the substantial new domestic smart meter market for homes and small businesses in the UK.

Alongside these installation businesses, Qton helps to serve SMS's existing and future contracts and helps to ensure full confidence to energy suppliers throughout the domestic smart meter rollout.

CH4 is a specialist in traditional and smart gas and electricity metering installations to the domestic and I&C sectors. It operates throughout the UK and was a service provider to SMS prior to acquisition.

Trojan is a leading installation service provider to energy suppliers in the UK and delivers domestic smart gas and electricity trained and accredited installation services.

Qton has a team of IT professionals specialising in the provision of work and field management IT systems applications for gas and electricity metering installations. The customers for the company's solutions are energy suppliers, installations contractors and meter asset managers and owners in the UK with specific applications tailored for domestic dual fuel smart installations.

The acquisition was accounted for using the acquisition method. The fair value of the identifiable assets and liabilities of each company as at the date of acquisition was as follows:

	CH4 £'000	Trojan £'000	Qton £'000	Total £'000
Property, plant and equipment	366	1,459	18	1,843
Software	—	500	1,500	2,000
Customer contracts	—	—	—	—
Other financial assets	—	109	—	109
Inventories	175	73	—	248
Trade and other receivables	1,622	673	228	2,523
Cash and cash equivalents	167	88	197	452
Total assets	2,330	2,902	1,943	7,175
Trade and other payables	(551)	(516)	(38)	(1,105)
Accruals and deferred income	(1,046)	(1,624)	(564)	(3,234)
Obligations under hire purchase agreements	(92)	(923)	—	(1,015)
Total liabilities	(1,689)	(3,063)	(602)	(5,354)
Acquisition date fair value of the assets	641	(161)	1,341	1,821
Goodwill arising on acquisition	1,359	579	1,559	3,497
Total consideration transferred (as equity instruments)	2,000	418	2,900	5,318

Analysed as:

	CH4 £'000	Trojan £'000	Qton £'000	Total £'000
Ordinary shares	4	—	7	11
Merger reserve	1,596	—	2,593	4,189
Deferred consideration	400	418	300	1,118
Total consideration	2,000	418	2,900	5,318

On 5 April 2016 1,072,055 ordinary shares were issued as consideration for the acquisitions of CH4, Trojan and Qton at a price of 391.775p.

27 Business combinations continued

Acquisitions of Trojan, CH4 and Qton continued

The fair value of the equity instruments (ordinary shares) issued as consideration paid was determined on the basis of the closing market price of SMS's ordinary shares on the date of acquisition.

There are no contingent consideration arrangements in any of the acquisitions.

The comparative financial information for 2016 includes the results of CH4, Trojan and Qton for the period 18 March 2016 to 31 December 2016, during which time:

	CH4 £'000	Trojan £'000	Qton £'000	Total £'000
The contribution to revenue by each company was:	907	5,115	871	6,893
And to Group profit for the period was:	(1,224)	(1,502)	351	(2,376)

If the combinations had each taken place at the beginning of the period:

	CH4 £'000	Trojan £'000	Qton £'000	Total £'000
The contribution to Group profit from each would have been:	(1,521)	(1,698)	(158)	(3,377)
And the contribution to revenue from continuing operations from each would have been:	2,140	6,576	1,163	9,879

The acquisitions of CH4 and Trojan were part of the Group's strategy to gain direct control of a large proportion of our installation capacity for ongoing delivery of our customer contracts in the I&C and Domestic meter markets. This continues to provide confidence to our customers in our delivery model for the new Domestic smart metering market. In addition, the acquisition of Qton allowed the Group to gain direct control and ownership of all software applications used by SMS for asset installation and ongoing management.

The goodwill recognised above is attributed to the expected benefits of securing our installation capacity and controlling our software applications.

None of the goodwill recognised is deductible for income tax purposes.

The primary components of this residual goodwill comprise:

- ▶ the workforce;
- ▶ the software capability;
- ▶ revenue synergies from dual fuel; and
- ▶ new opportunities available to each company as part of the larger AIM-listed Group.

The identifiable intangible assets will be amortised as follows:

- ▶ Software – 20%
- ▶ Customer contracts – 20%

Transaction costs and expenses directly relating to the acquisitions of £455,000 have been disclosed as exceptional items in the 2016 comparative figures.

28 Post balance sheet events

In February 2018, the Company paid its revolving credit facility down by £100m.

Parent company balance sheet

As at 31 December 2017

	Notes	2017 £'000	2016 £'000
Fixed assets			
Investments	2	22,254	22,254
Current assets			
Debtors	3	155,792	5,860
Creditors			
Amounts falling due within one year	4	627	1,118
Net current assets		155,165	4,742
Total assets less current liabilities		177,419	26,996
Capital and reserves			
Called up share capital	6	1,124	892
Share premium	7	158,592	10,861
Other reserve	7	9,561	8,446
Treasury shares		(697)	—
Profit and loss account	7	8,839	6,797
Equity shareholders' funds		177,419	26,996

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 £6,000,000 for the financial year ended 31 December 2017 (2016: £7,000,000).

The parent company financial statements on pages 78 to 81 were approved and authorised for issue by the Board of Directors and signed on its behalf by:

David Thompson

Director

13 March 2018

Company registration number

SC367563

Parent company statement of changes in equity

As at 31 December 2017

Attributable to the owners of the parent company	Share capital £'000	Share premium £'000	Other reserve £'000	Treasury shares £'000	Retained earnings £'000	Total £'000
As at 1 January 2016	861	9,650	4,257	—	2,942	17,710
Total comprehensive income for the year	—	—	—	—	7,000	7,000
Transactions with owners in their capacity as owners						
Dividends (note 8)	—	—	—	—	(3,145)	(3,145)
Shares issued	31	1,211	4,189	—	—	5,431
As at 31 December 2016	892	10,861	8,446	—	6,797	26,996
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)
Shares held by SIP	—	—	—	(697)	70	(627)
Shares issued	232	147,731	1,115	—	—	149,078
As at 31 December 2017	1,124	158,592	9,561	(697)	8,839	177,419

Notes to the parent company financial statements

For the year ended 31 December 2017

The parent company financial statements of Smart Metering Systems plc ("the Company") for the year ended 31 December 2017 were authorised for issue by the Board of Directors on the 13 March 2018 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 2017. 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 11.39 to 11.48A;
- ▶ section 12 Other Financial Instruments Issues, paragraphs 12.26 to 12.29A; and
- ▶ section 33 Related Party Disclosures, paragraph 33.7.

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.

2 Investments

Company	Group companies £'000
Cost	
As at 1 January 2017	16,902
Additions	5,352
As at 31 December 2016 and 31 December 2017	22,254
Net book value	
As at 31 December 2016 and 31 December 2017	22,254
As at 31 December 2016	22,254

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.

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

	2017 £'000	2016 £'000
Amounts owed by Group undertakings	155,792	5,860

4 Creditors: amounts falling due within one year

	2017 £'000	2016 £'000
Other creditors	—	1,118
Amounts due to Group undertakings	627	—
	627	1,118

5 Related party transactions

During the year, the Group paid dividends to Alan Foy of £320,973 (2016: £269,548), Miriam Greenwood of £723 (2016: £421), Willie MacDiarmid¹ of £265 (2016: £Nil) and Graeme Bissett of £237 (2016: £Nil).

¹ Paid to a connected person.

6 Share capital

	2017 £'000	2016 £'000
Allotted and called up:		
112,450,800 ordinary shares of £0.01 each (2016: 89,203,739 ordinary shares of £0.01 each)	1,124	892

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 net proceeds of the placing are to be utilised alongside the extended debt facility to give SMS plc the financial and operational flexibility to fully fund the installation of approximately 2.5 million meters.

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On 5 April 2016 and on 15 September 2016, 1,072,055 ordinary shares and 285,367 ordinary shares were issued as consideration for the acquisition of CH4 Gas Utility and Maintenance Services Limited ("CH4"), Trojan Utilities Limited ("Trojan") and Qton Solutions Limited ("Qton").

7 Other reserve

This is a non-distributable reserve that initially arose by applying merger relief under section 162 of the Companies Act 2006 to the shares issued in 2009 in connection with the Group restructuring. This was previously recognised as a merger reserve under UK GAAP. Under IFRS, this has been classed as an "other reserve". 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.

Produced by

designportfolio



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