MEARS

Mears Group

Final results for the year ended 31 December 2020

12th May 2021

EXECUTIVE SUMMARY

"The strength of our people, our infrastructure and our client relationships have served us well through Covid-19."

Key themes	Key messages
Exceptional operational delivery	• Robust response to Covid-19 ensured service levels remained high • Client support and relationships strengthened • Workforce support, engagement and morale remained high
Financial resilience	• Resilient revenue performance • Profit recovery in H2'20 and into Q1'21, well-set for full recovery • Strong cash performance
Strategic objectives achieved	• Completed planned strategic actions • Significant reduction in underlying debt level • Strategy and infrastructure in place for full recovery

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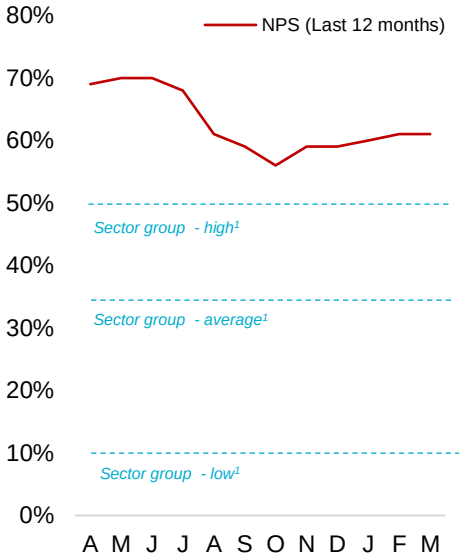
OPERATIONAL DELIVERY

"Mears responded quickly and diligently to the challenges of 2020 to ensure customers, clients and our people were supported."

Customers

Customer service levels remained high

- Internal and external (NPS) customer satisfaction scores remained very high



Clients

Client relationships strengthened

- Clients supportive through interim financial arrangements
- Effective IT systems enabled quick transition to remote working & retention of full client oversight
- Significant contract extensions agreed

Strong operational delivery on key Central Govt contracts

- Delivered on the requirements within AASC contract with additional Covid-19 requirements
- Strong operational KPI performance Key Worker/MOD contract ahead of 2021 re-bid

Workforce

Workforce support measures

- Increased employee communication
- Group supported furlough top-up payments (2,200 on furlough at peak. Now: none)
- PPE and Covid-19 protocols for front-line staff
- Employee director appointed

Increased workforce engagement throughout the pandemic

- Retained Sunday Times "25 Best Companies to Work For" accreditation
- Recorded highest ever scores in employee "Pulse" survey (July20)
- Retained Social Mobility and Diversity accreditations

1. Sector group high, low and average, based on research performed by SMOKE Customer Intelligence (www.smokeci.com), taking into account over 35,000 responses to the NPS (Recommend) question from different "services" companies they work with.

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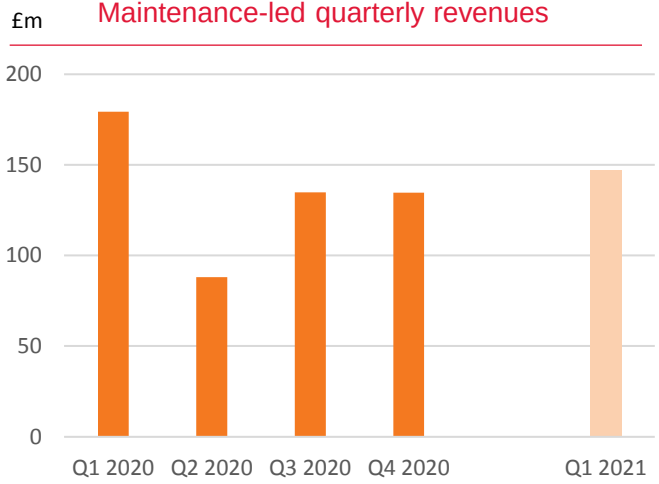
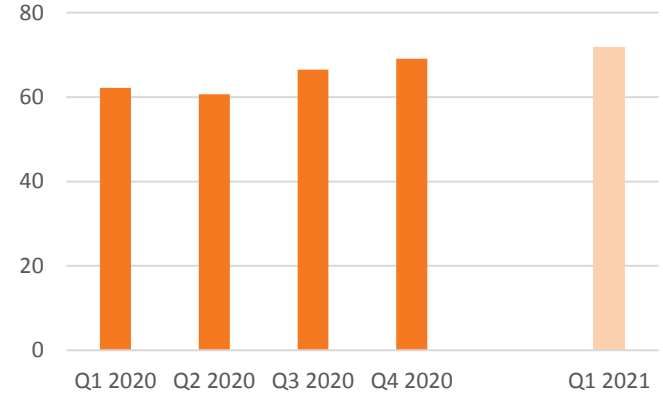
FINANCIAL RESILIENCE

"Swift management actions and strong customer support helped mitigate downside in Q2 and revenues remained robust."

Maintenance-led quarterly revenues



Management-led quarterly revenues



Commentary

Resilient revenues

- Group revenues[1] £805.8m (2019: £881.5m) down 9%
  - Maintenance-led revenues £536.9m down 19% impacted by reduced activity
  - Management-led revenues of £258.5m up 40% reflecting full year AASC

Profit recovery

- Interim cost re-imbursement model agreed with most clients
  - protected against significant downside risk
  - but did not cover overheads and profit
- The Group returned to profitability in H2: £4.8m[2] (H1: £8.2m loss).

Strong cash performance

- Net cash[3] at 31 December 2020 of £56.9m (2019: £50.9m net debt)
- Underlying average daily net debt[4] estimated at: £65m (actual FY20: £97m; 2019: £114m)

1. Revenues on a continuing basis. 2. Normailsed profit / loss before tax excludes amortisation of acquired intangibles and exceptional items. 3. Net debt / (cash) prior to IFRS 16 lease oblifgations. 4. Average daily net debt for FY2020 adjusted for Terraquest disposal and unwind of Covid-related cashflow benefits

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STRATEGIC PROGRESS FY2020

"During FY2020 we substantially completed our transition to a low capital intensity Group and consolidated our position as a leading housing specialist."

Strategic objectives	FY 2020 achievements
Review non-core activities	• Successful disposal of Terraquest business • Completed exit from Domiciliary care businesses
Significantly reduce debt	• Strongly net cash[1] at 31 December 2020 of £56.9m (2019: £50.9m net debt)
Improve returns on invested capital	• Positive working capital performance through the pandemic • Unwind of development will provide working capital tailwind over next 2 years
Long term growth	• Strong demand profile given the shortage of affordable housing in the UK • The Group is now a major player when it comes to the large multi faceted opportunities (Key Worker, Home Office, North Lanarkshire)

1. Net debt / (cash) prior to IFRS 16 lease obligations.

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MEARS TOMORROW: STRATEGIC PILLARS

"After a period of strategic transition and Covid-19 disruption, Mears has a number of simple market, growth, and margin drivers across its Housing business."

Market Drivers

- Social Housing white paper (Nov 2020) call for greater quality and engagement in public sector housing
- Continued investment in affordable housing sector
- Demographic pressures
- Local Authority spending on better Homelessness solutions

Growth Drivers

- Leverage market leadership in Maintenance to cross-sell/upsell our broader housing services
- Assist clients through our broad offer of housing solutions
- Continue to evolve our affordable housing solutions
- Well positioned for large multi faceted housing solutions contracts that would not historically have formed part of the pipeline
- Indexation mechanisms within contracts

Margin Drivers

- Return to normal charging mechanisms and improving margins as restrictions ease
- Continued digital innovation e.g. MCM Live
- Operational efficiencies

"Together with our strengthened balance sheet and good cash generation, we look forward with confidence"

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ORDERBOOK AND PIPELINE

"£2.6bn high quality orderbook and pipeline building."

Commentary

£2.6bn orderbook as Dec-20

- Benefitted from some significant extensions
- Improved orderbook quality and visibility

High win rate

- Quiet year for bid activity as processes delayed due to Covid-19
- FY2020 order intake > £150m (Exeter, Hammersmith, Islington, Cornwall (new))
- FY2021 YTD order intake > £100m (Redbridge, Angus (new), Leeds)

Active pipeline

- Bid activity returning across the sector
- New work bid pipeline building, including FDIS (Lot 2) c.£25m pa
- Retention bid pipeline: c.£100m pa, including RLAP and Lambeth

Outlook

- Further central government housing management opportunities
- Large integrated opportunities (North Lanarkshire)

Orderbook

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ENVIRONMENTAL SOCIAL AND GOVERNANCE

"As a responsible service-provider to the public sector, Mears has always been committed to the lives of the customers we support, the communities in which they live, the quality of our staff experience and more recently the environmental agenda. This is a core purpose for the company and, accordingly, for those who work within it."

FTSE4Good

Awarded a place in FTSE4Good Index which places Mears in the top 9% of companies in the index

MSCI

ESG Ratings

A

SUSTAINALYTICS
a Morningstar company

26.4

Environmental

Supporting our clients net zero ambitions

- Active with clients in the retrofitting of domestic heating
- Appointed a Head of Carbon Reduction in FY2020 to support clients in meeting government commitments
- We actively seek to incorporate environmental standards into all contracts we agree

Mears Net Zero

- Developing our plans to be carbon neutral through our own operations by 2030
- Re-cycle > 90% of our waste

Social

Diversity and Social Mobility

- Externally appointed Social and Diversity Impact Board
- Accredited by the Housing Diversity Network
- Signed the Employers Social Mobility Pledge
- Staff development (2019 last base year: 67 management qualifications, 142 NVQs and > 540 apprentices)

Social Value

- Each employee tasked with generating £2,500 of Social Value for the communities we serve (2020: £2,540 or £12m)

Accident frequency rate (AFR[1])

- Target below 0.25 (2020: 0.15)

Governance

Board

- One of the few UK-listed companies to appoint an Employee Director
- The Mears Workforce Group, which reports to the main board, leads on our workforce engagement programme

Operational scrutiny

- Launched 'Your Voice' in 2020, a comprehensive customer engagement forum, with an independent chairman supported by TPAS, the tenant engagement experts.

Controversies

- Mears serves many vulnerable user groups, priority is always given to the safety of customers and staff

ServiceMark · INVESTORS IN PEOPLE · TOP 75 SOCIAL MOBILITY EMPLOYER INDEX 2019 · FTSE4Good · tpas · RoSPA Order of Distinction · 25 BEST BIG COMPANIES 2020 · DIVERSITY NETWORK ACCREDITATION · SOCIAL VALUE COMMIT 1 CERTIFICATE

1. AFR is calculated as the number of reportable incidents (by both employees, service users and third parties) divided by the number of hours worked multiplied by 100,000.

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CURRENT TRADING AND OUTLOOK

"Our business is in good shape and demand for our specialist range of housing services has never been greater."

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Current trading update

Resilient trading and liquidity performance in Q1'21

- Solid revenue performance
- Group profit continues to recover, underpinned by interim Covid-19 arrangements
- Strong cash and working capital management, with average daily net debt across Q1 of £17m

Outlook

- Full recovery expected as all restrictions are lifted through Q2'21
- Greater weighting of profits to H2
- The Board is comfortable with current market consensus expectations for revenues and adjusted profit before tax for the current financial year

Re-instating FY21 guidance

Measures	FY21 guidance
Revenues	In line with market expectations *(Revenues: £770m-£820m)*
Profit before tax (before exceptionals and amortisation of acquired intangibles)	In line with market expectations *(PBT: £21.3-25.5m)*
EBITDA to operating cash conversion	>100% *(after adjusting for VAT deferral and client payments received on account)*
Growth capex	No material requirement
Capital structure	Continued debt reduction
Capital returns	Return to dividend list once prudent

Financials

Andrew Smith, CFO

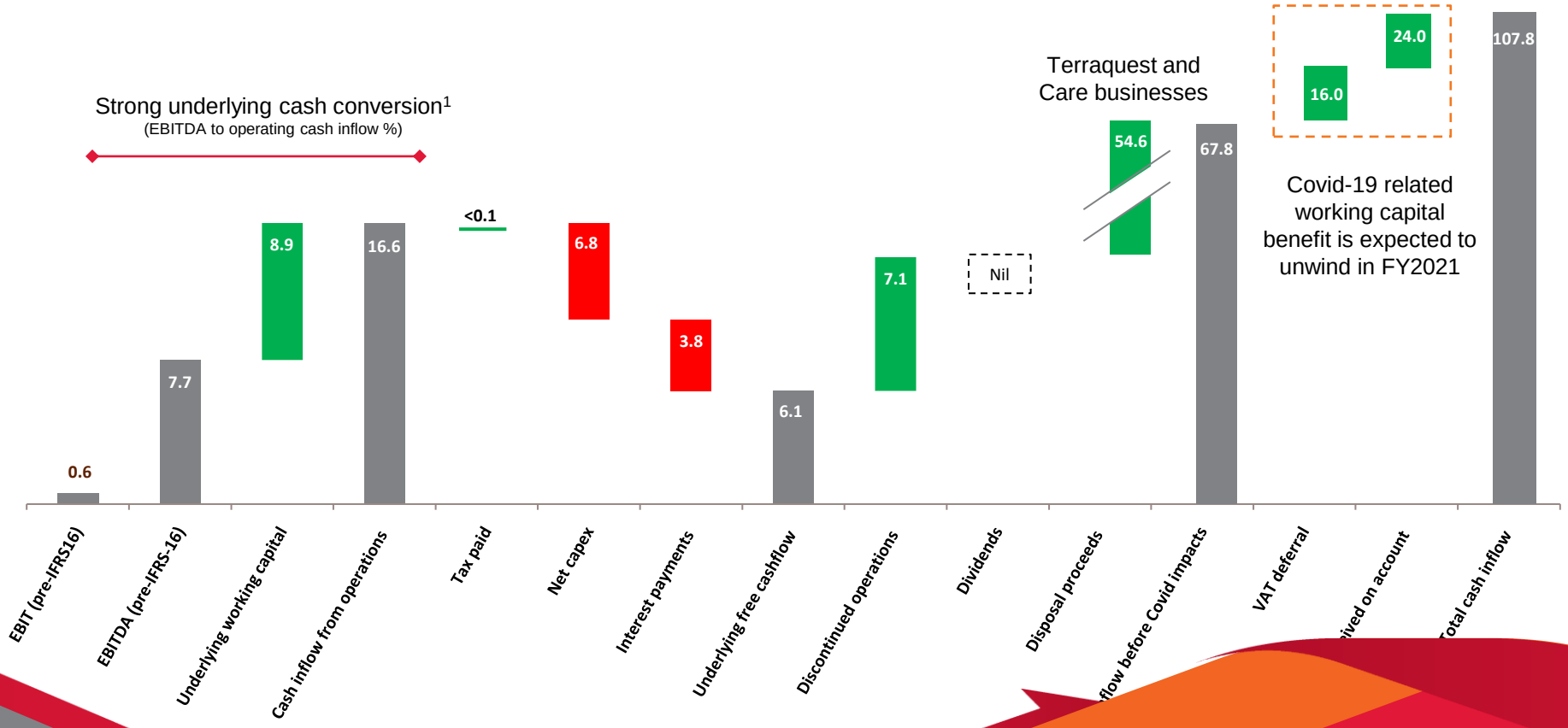
Resilient revenue performance and profit recovery in H2

Continuing activities	H1 2020 £m	H2 2020 £m	**FY 2020 £m**	2019 £m
Revenue				
Maintenance-led	266.9	270.0	**536.9**	660.7
Management-led	121.2	132.6	**253.8**	181.3
Development	8.6	6.5	**15.1**	39.5
Total	396.7	409.1	**805.8**	881.5
Profit measures				
Adjusted operating (loss) / profit (pre-IFRS16)	(5.9)	6.5	**0.6**	37.6
	(1.5%)	1.6%	**0.1%**	4.3%
Adjusted operating (loss) / profit (post-IFRS16)	(3.1)	9.7	**6.6**	41.4
	(0.8%)	2.4%	**0.8%**	4.7%
Adjusted (loss) / profit before tax	(8.2)	4.8	**(3.4)**	32.4

- **Maintenance-led revenues down 19%, compensated in part by a 40% increase in Management-led activities**
  - Some reduction in Maintenance revenue run-rate prior to pandemic
  - Restrictions on service delivery under regional and national lockdowns mitigated by lump sum contracts and interim financial arrangements agreed with clients
  - Full year impact of AASC, mobilised in September 2019; strong demand for additional services throughout the pandemic

- **Operating profits and margins impacted by:**
  - Interim arrangements typically recover local overheads but an under-recovery of central overheads and profit
  - Mothballing of Development activities following the first national lockdown combined with a reassessment of associated carrying values
  - Incremental costs incurred in addressing the impact of the pandemic

Strong cash generation



1. Includes £0.8m of exceptional cash costs

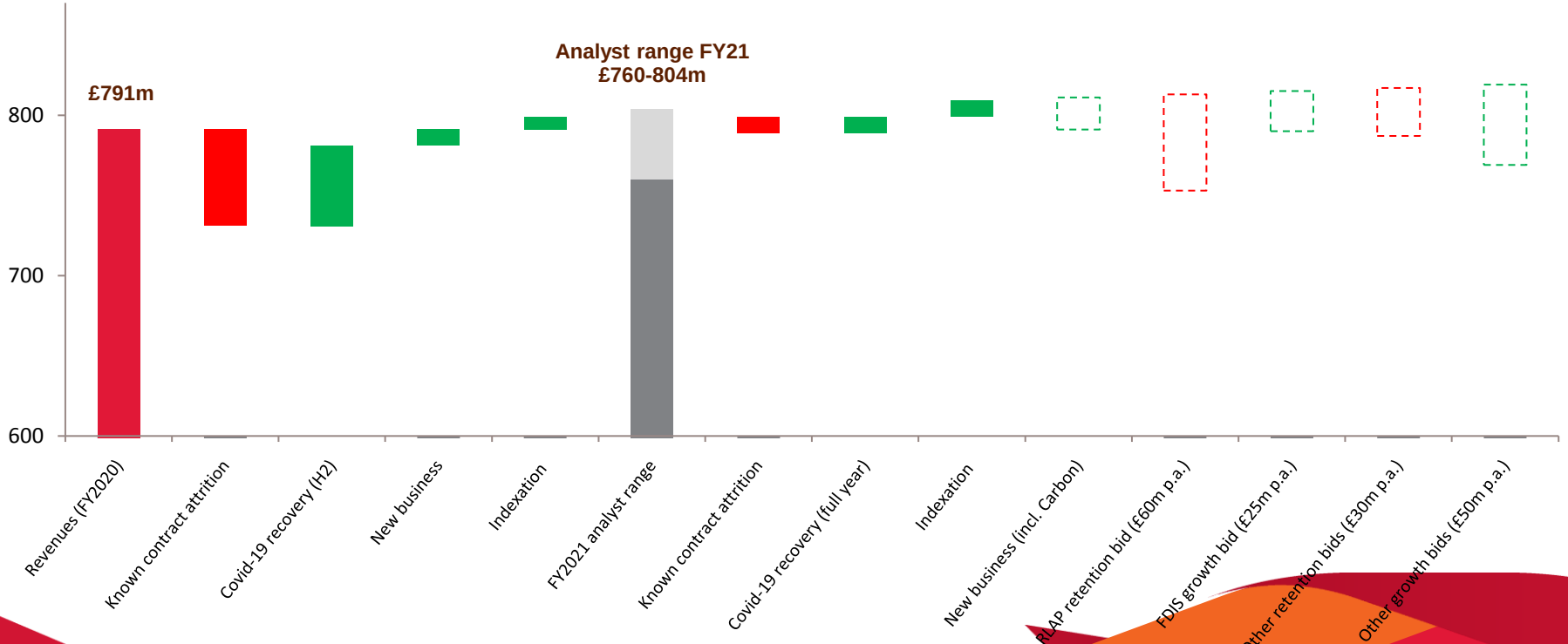
Significantly strengthened balance sheet

Balance Sheet	2020	2019
	£m	£m
Non-current assets		
Goodwill and Intangibles	135.0	152.4
Property, plant, equipment and investments	23.6	26.3
Right of use assets	200.0	198.4
Non-current assets	**358.7**	**377.1**
Working capital balances		
Inventories	31.3	36.0
Trade receivables and contract assets	139.9	164.1
Trade payables and contract liabilities	(221.4)	(202.2)
Net working capital	**(50.2)**	**(2.0)**
Net debt		
Cash and equivalents	96.2	72.9
Gross debt	(39.3)	(124.0)
Net cash / (debt)	**56.9**	**(51.1)**
Other liabilities		
Lease liabilities	(209.1)	(205.2)
Net pension liabilities	(7.9)	2.1
Taxation	3.7	(2.2)
Other	4.0	(0.1)
Net assets	**156.1**	**118.3**

- **Disposal of Terraquest delivers significant debt reduction**
  - Also increases net assets and distributable reserves
- **IFRS 16**
  - Prior year adjustment to IFRS 16 methodology significantly reduces both sides of the balance sheet
- **Pension schemes**
  - The Company schemes are in a small surplus and the contract-specific schemes a small deficit. The large majority of these contract-specific schemes benefit from pension guarantee assets and pension risks are well managed

Revenue drivers (excl. Development)

→ **Group order book at £2.6bn (2019: £2.5bn)**



Post-Covid margin drivers

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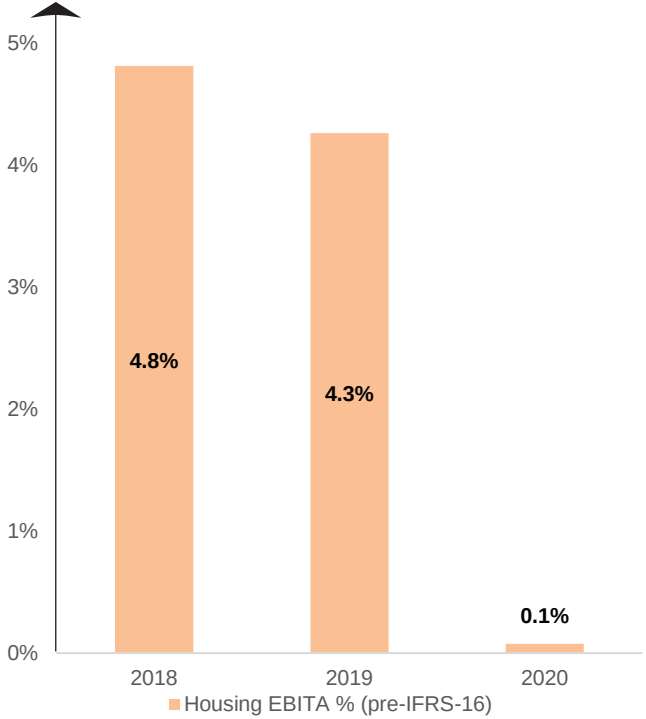
Adj. operating profit margins (pre-IFRS-16)[1]



Margin drivers going forward

Exit from interim financial arrangements

- Negotiated on a contract by contract basis as volumes return

Completion of Development unwind

- Expected nil margin in FY21 and FY22

Target pricing at 5%

- New business pricing across Maintenance and Management targets 5%+

Contract rationalisation and operational consistency/efficiency

- Exit from under-performing and unsupportive contracts in H1 2020

New contract wins

- Mobilisation is margin dilutive in the first year

'Long' Covid impacts

- Still expect some additional costs and inefficiencies (e.g. PPE, social distancing)

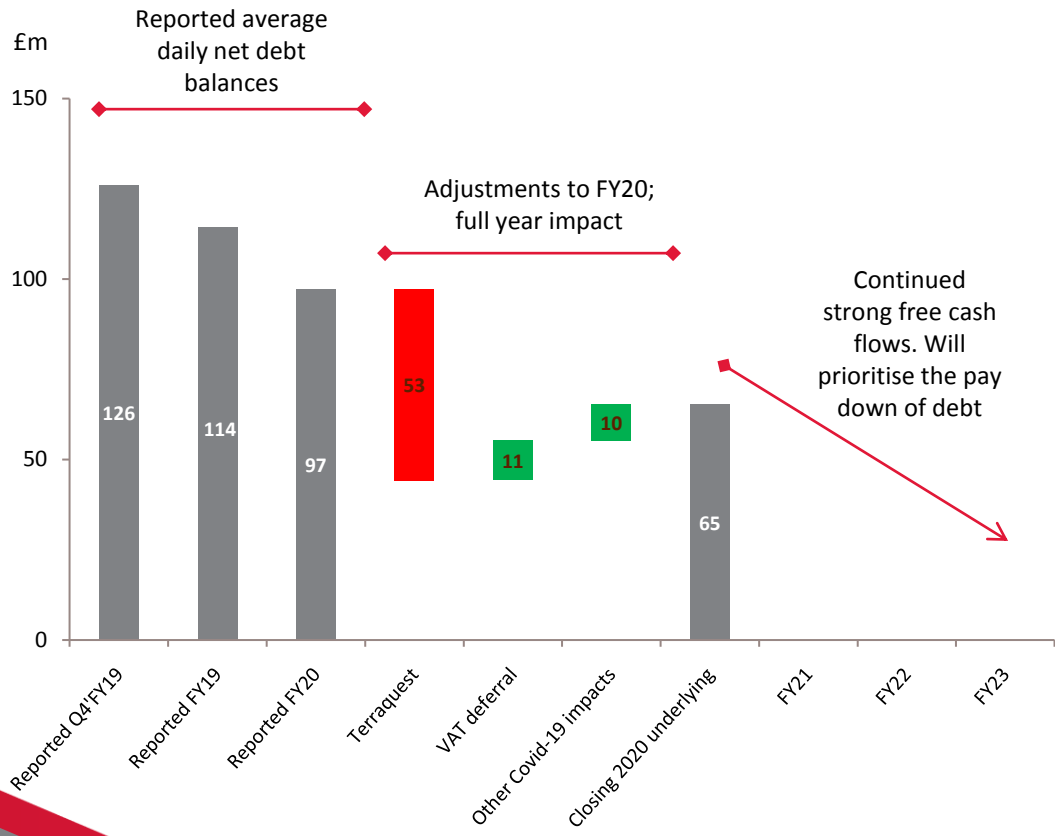
Larger integrated contracts

- Some larger contracts in the pipeline may have a different margin structure

Overhead recovery

1.Continuing Housing EBITA excludes contributions from businesses discontinued in the period (Domiciliary Care and Terraquest disposed of in 2020).. EBITA is stated pre IFRS 16 for comparability across the period.

Significant reduction in underlying net debt…



…will continue in FY21-22

Cash generation:

- Continue to target > 100% EBITDA to operating cash inflow
  - No significant increases in working capital requirements, once Covid-19 impacts unwind
  - Unwind of Development working capital over next 2 years
- Capex requirements at 1.25% of revenues (£9-10m per annum)
- Cash tax reverting to near 19%
- Cash interest reducing < £2m

Capital allocation:

- Continue to prioritise the paydown of average net debt
- No material investment required to fund growth over the next two years
- Will return to the dividend list once prudent to do so
  - Well covered by profits and cash

IFRS 16 summary

IFRS 16 - balance sheet impacts	2020	2019 restated	2019 reported
Right of use asset	200.0	198.4	264.6
Lease obligations	(209.1)	(205.2)	(269.3)
IFRS 16 net asset impact	**(9.0)**	**(6.8)**	**(4.8)**

IFRS 16 - P&L impacts	2020	2019
IFRS 16 Depreciation *(Charged in arriving at EBITA and operating profit)*	42.2	29.9
IFRS 16 Interest *(Charged to P&L as part of finance costs)*	7.1	5.8
Total	**49.4**	**35.7**
Lease payments on IFRS 16 leases	*48.2*	*33.4*
IFRS 16 PBT impact	**(1.1)**	**(2.2)**
IFRS 16 impact on reported operating profit/EBITA	***6.0***	***3.5***

Prior year adjustment

- Reassessment of leases associated with the Mears' 'More homes' homelessness solution
  - Mears is deemed to not control the asset or to derive economic benefit from the asset; reduction in right of use asset and associated lease obligation by c. £65m
  - Mears delivers tenancy management and maintenance services
  - Local Authority makes tenants available through a nominations agreement and underwrites void loss and bad debt risk

IFRS 16 accounting

- IFRS 16 focusses on a lessee's right to control an asset
  - At inception of a lease, a right of use asset is recognised on the balance sheet equivalent to the present value of all future lease payments; a corresponding lease obligation is also recognised
  - The lease obligation is not consistent with the historical definition of a liability; it is not a typical debt instrument
  - Mears utilises leases to mitigate its operational and financial contractual risks

IFRS 16 – accounting for leases

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IFRS 16 only relates to operating leases where the lessee is deemed to have the right to direct the use of the asset. This table below considers in brief the main different classes of residential lease assets, their key contractual obligations, the associated risk and reward and the accounting treatment.

Lease type	Number of leases	Typical lease terms	Annual lease payments (£m)	IFRS 16 asset/liability	Key risk mitigants	Risk rating (RAG)
Category A	2,480	3-5 years	16.3	32.4	Mears has a 'no-fault' break clause, with ability to exit within 30-days	
Category B	380	7-10 years	3.8	23.7	Lease term are matched to underlying contract length plus novation rights	
Category C	635	3-20 years	9.3	85.0	Nominations agreement with Local Authority provides protection against void loss and bad debt	
Categoty D	400	c.20 years	3.5	42.4	Sub-market rent	
Total	**3,895**		**32.9**	**183.5**		
Category E	660	10 years	4.2	-	Two-way no fault break clause on two months notice	
Category F	1,065	7-10 years	9.3	-	Lease term are matched to underlying contract length plus novation rights	
Category G	500	20 years	4.6	-	Rent guarantee and void protection	
Category H	4,005	< 1 year	47.9	-	Short term obligations	
Category I	300	3 years	3.0	-	Pass-through arragement (only pay when paid by tenant)	
Total	**6,530**		**69.0**	-		
Vehicles / offices	**3,500**	c. 5 years	15.6	25.6	Easily transferable between contracts	
Grand total	**13,925**		**117.5**	**209.1**		

Q & A

David Miles, CEO

Andrew Smith, CFO

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