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Mears Group PLC

Interim results for period ended
30 June 2020

Presentation team

→ David Miles	Chief Executive Officer
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Agenda

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→ Operational review

→ Finance review

→ Strategic update

→ Outlook

Operational review

H1 – Strategic Highlights

- **Mears well placed in early 2020 progressing a number of its strategic priorities:**
  - AASC contract fully embedded
  - MPS acquisition fully integrated and on-track
  - Exit from England and Wales Domiciliary Care completed; unwinding of funded development progressing
  - Maintenance contract win rate over 80%
- **Covid-19 - coped well in very difficult circumstances:**
  - Maintained essential services whilst ensuring safety of employees and service users
  - Liquidity remained strong

H1 – Financial Highlights

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→ **Resilient financial performance despite significant disruption from Covid-19:**

- → Jan-Feb trading in-line
- → H1 Revenue: £407.0m (H1 2019: £439.2m)
  - → Lower Maintenance revenues (emergency only service) partly offset by ramp up in AASC contract
- → H1 Adjusted operating loss: £1.0m[1] (H1 2019: £22.7m profit)
  - → Maintenance: interim arrangements covered direct costs in majority of contracts
  - → Management: key worker/essential services largely unaffected
  - → Development: sites mothballed; adjustments to carrying values
- → H1 liquidity remained resilient; avg. daily net debt: £121.2m (H1 2019: £110.7m)
  - → Facilities extended to £192.7m and interim dividend suspended
- → H1 Normalised diluted EPS: (4.28p) [1] (H1 2019: 11.99p)

1. Continuing operations; stated before amortisation of acquisition intangibles and normalised EPS is calculated using a full tax charge.

Half year by business unit | Maintenance

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Client support

- Largely supportive recognising government guidance:
  - interim agreements to recover direct costs *(schedule of rates ('SOR') contracts)*
  - revenue and payments maintained at normal levels *(Lump sum contracts)*
  - No financial support in a small number cases

Work volumes

- Covid-19 required shift to emergency-only service:
  - work volumes c. 15% of normal[1] (late March to May) with some recovery in June
  - cautious approach to restart through July
- Volumes expected to return to normal by the end of the financial year

Staff

- Monumental effort and dedication from all our teams
- Maintained the highest service-levels despite the most challenging of conditions
- 30% of Maintenance workforce furloughed at peak

Challenges / Opportunities

- Operational challenges were immense and will continue as volumes rebuild
- Replacement cycles and maintenance backlogs should underpin demand
- Mears well placed when procurement processes return to normal

1. As measured by maintenance 'ticket' volumes against run-rate

Half year by business unit | Management

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Client support

- → Central government clients (DIO & Home Office) very supportive
- → Contracts largely unaffected due to their essential nature
- → Additional payments received to share burden of incremental Covid-19 costs

Work volumes

- → Key Worker, Asylum and 'Housing with Care' accommodation contract volumes largely unaffected
- → Some challenges / delays with move ins
- → Reduced focus on emergency homelessness solutions

Staff

- → Monumental effort and dedication from all our teams
- → Significant additional operating procedures to keep staff and customers safe
- → Small number of staff furloughed

Challenges / Opportunities

- → Operational challenges will continue, but Mears core competencies well placed to resolve these
- → Strong current demand for services presents upside potential, but accompanying operational challenges
- → Continuing 'Housing with Care' business performing well

Robust business resilient through Covid-19 difficulties

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Focus area	Importance during Covid-19	Implications for the future
Quality of contract portfolio and client relationships	→ Balanced contract portfolio across local/central, SOR/lump-sum, and essential/discretionary → Financial support from clients largely underpinned cost recovery and positive cashflow	→ Exited a small number of contracts, where support not forthcoming → Well-balanced order book going into 2021
High-service levels, systems and processes	→ Meeting the Covid-19 challenge demonstrated Mears' operational capability and flexibility → Retained customer satisfaction scores, way above benchmark (Mears NPS: 68%; benchmark: 43%) [1]	→ High-performance, actions and behaviours during the crisis will build long-term trust with clients[1] → Volumes returning progressively through H2
Our people	→ Dedication and professionalism of our people has been exemplary → Focus on workforce communication helped maintain key disciplines and morale	→ Return to work has started well, as reflected in a positive response to a 'pulse' staff survey in June → However, some rationalisation required to ensure workforce is right-sized for 2021
Liquidity	→ Liquidity healthy despite significant challenges → Banks supportive of precautionary facility extension during the period	→ Stress testing of second UK lockdown scenario, confirms sufficient liquidity → De-leveraging actions will resume in H2

1. SMOKE Customer Intelligence Survey (March-April 2020) versus cross-industry comparators

Finance review

Income statement (continuing operations)

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	As reported		Before the impact of IFRS 16	
	H1 2020	H1 2019	**H1 2020**	H1 2019
	£'000	£'000	**£'000**	£'000
Sales revenue	**406,963**	439,227	**406,963**	439,227
Cost of sales	**(327,445)**	(331,214)	**(329,834)**	(333,635)
Gross profit	**79,518**	108,013	**77,129**	105,592
Other administrative expenses	**(80,525)**	(85,274)	**(80,525)**	(86,704)
Exceptional costs	**-**	-	**-**	-
Operating result before amortisation of acquisition intangibles	**(1,007)**	22,739	**(3,396)**	18,888
Share of profits of associates	**357**	-	**357**	357
Finance income	**163**	660	**163**	163
Finance costs	**(5,303)**	(6,725)	**(1,876)**	(2,092)
(Loss)/profit for the period before tax and amortisation of acquisition intangibles	**(5,790)**	16,674	**(4,752)**	17,316

- £2.5m of non-recurring costs associated with Covid-19 included within normal trading
- Pre-IFRS 16 figures provided to assist comparability

Segmental reporting

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	2020			2019		
	Revenue	**Operating profit / (loss)**	**Operating margin**	Revenue	Operating profit / (loss)	Operating margin
	£m	**£m**		£m	£m	
Maintenance	**261.7**	**(0.9)**	**(0.3%)**	323.3	15.4	4.8%
Management	**135.7**	**3.8**	**2.8%**	88.2	8.2	9.3%
Development	**9.6**	**(3.6)**	**(37.5%)**	27.7	(0.9)	(3.2%)
Operating result	**407.0**	**(0.7)**	**(0.2%)**	439.2	22.7	5.2%

* All figures stated after IFRS 16 and includes share of profits in associates

Revenue split

	Q1	**Q2**
	£m	**£m**
Maintenance	166.5	95.2
Management	67.7	68.0
Development	8.6	1.0
	242.8	164.2

- **Maintenance**
  - Revenues impacted by Covid-19 with significant reduction in volumes
  - Interim arrangements mitigated downside risk; some under-recovery of central overheads and a small number of material loss-makers
- **Management**
  - Strong growth underpinned by AASC
  - Some reduction in emergency homelessness solutions as planned
  - Some margin reduction during Covid-19 period but key contracts performing well
- **Development**
  - Activities mothballed
  - Operating result impacted by reassessment of costs to complete and likely sales valuation

Performance of Maintenance contracts in H1

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Emergency-only service to all clients

Volumes[1]

- 85%

Contracts drivers of revenue and margin performance

→ **Maintained capability and cost base to provide emergency cover**

  → furlough c. 30% of staff at peak

→ **Recovery of these costs negotiated on a case-by-case basis depending on contract-type:**

→ *Volume-linked ('SOR') contracts (c.80% of portfolio by value)*

  → Reimbursement model to recover direct costs of emergency cover

  → Reduction in profit entitlement and limited recovery of central overheads

  → Small number of contracts exited where such interim financial arrangements not forthcoming

→ *'Lump sum' contracts (c. 20% of portfolio by value)*

  → Largely billed as normal, but 'fully costed' at normal activity levels

→ **c.£2.0m of additional operating costs, furlough top-up costs and restructuring costs**

Financial performance of Maintenance Division H1 2020 versus H1 2019

Revenues

-19%

Adj. operating profit[2]

-93%

1. Maintenance contract activity levels versus 'normal' Mar-Jun 2020
2. Maintenance adjusted operating profit of £1.1m (2019: £14.9m) after adding back £2.0m of Covid-19 related incremental cost and including the share of profit in associate.

Working capital

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	6 month average to June 2020			12 month average to December 2019		
	Receivables	**Payables**	**Net working capital**	Receivables	Payables	Net working capital
	£m	**£m**	**£m**		£m	£m
Maintenance	**141.9**	**(121.1)**	**20.8**	159.3	(126.2)	33.1
Management	**36.4**	**(24.6)**	**11.8**	29.8	(24.3)	5.5
Development	**36.8**	**(8.2)**	**28.6**	33.4	(8.7)	24.7

→ **Maintenance**
- → Large contraction in Q2, in line with reduced activity, shorter client payment terms and Government reliefs

→ **Management**
- → Expansion following full mobilisation of AASC

→ **Development**
- → Small working capital increase reflecting a slowdown in market sales in the period
- → Inventories still expected to unwind completely over the next two years

Cash flow and net debt

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	H1 2020 £'000	H1 2019 £'000	FY 2019 £'000
EBITDA	**26,897**	42,381	88,624
Working capital movements	**(4,836)**	1,731	11,626
Cash inflow from operations	**22,061**	44,112	100,250
	82.0%	104.1%	113.1%
Total average daily net debt (operating)	**(121,200)**	(110,700)	(114,400)
Net debt (operating) at period end	**(62,170)**	(48,610)	(50,986)
Net debt (property acquisition facility) at period end	**-**	(15,000)	-
Total net debt at period end*	**(62,170)**	(63,610)	(50,986)

* lease obligations excluded from net debt measure

- → **Good working capital management in the first half**
  - → Interim arrangements agreed with majority of clients
  - → Lump sum contracts provided short-term cash benefit
  - → Deferral of March 2020 VAT liability; circa £17m
- → **Precautionary increase in Revolving Credit Facility**
  - → increased from £170.0m to £192.7m
- → **Improving liquidity throughout Covid-19 period,** with average daily net debt:
  - → Q1: £130.2m,
  - → Q2: £112.5m,
  - → Q3: to date <£100.0m

Consolidated Balance Sheet

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	Jun-20	Dec-19	Jun-19
	£'000	£'000	£'000
Goodwill and intangibles	**147,380**	151,846	225,637
Property, plant and equipment	**25,821**	26,326	25,398
Right of use asset	**264,210**	264,576	167,476
Working capital	**293**	(8,183)	13,166
Net debt	**(62,438)**	(51,138)	(48,610)
Pensions	**(10,737)**	2,088	11,866
Taxes	**1,965**	(2,344)	(2,345)
Lease liabilities	**(269,650)**	(269,345)	(175,944)
Assets for resale	**2,024**	5,293	(2,408)
Dividends	**-**	-	(9,778)
Other	**(436)**	(126)	(165)
Total equity	**98,431**	118,993	204,293

- → **Intangibles**
  - → Reduction from Jun-19 reflects impairment of Domiciliary Care assets in FY 2019
- → **Working capital**
  - → Solid performance
- → **IFRS 16**
  - → Significantly alters shape of the Balance Sheet; Right of Use asset and Lease Liability
- → **Assets for resale**
  - → Relates to Scotland Domiciliary Care (Dec-19 included England & Wales)
- → **Pensions**
  - → Reduction in discount rates moving balance to a small deficit
  - → Risks carefully managed; no increase in contributions expected

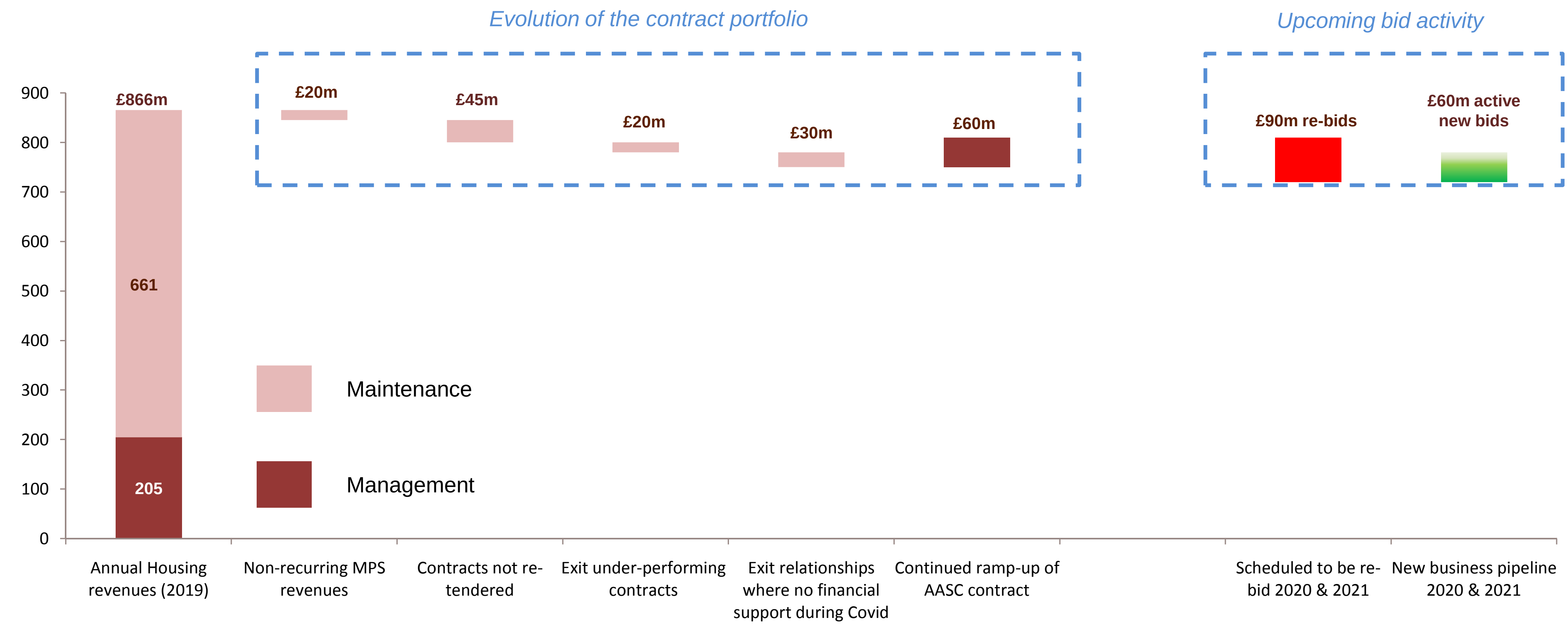
Strategic update

2021 ready | Focus on specialist housing services

- **Following a period of strategic re-positioning Mears' clear and unique offer is coming into sharper focus:**
  - A specialist provider of housing services
  - Simplification of operational delivery into two service focussed divisions
    - **Maintenance:** *Repairs and Maintenance of homes in partnership with Local Authorities and Housing Associations*
    - **Management:** *Management of homes and accommodation for key worker/vulnerable groups*
  - Contracting with Local and Central Government clients
  - Delivering contracts aligned to Mears' core competencies
  - Leading market position and trusted client relationships built over many years provides strong foundation
  - Reduced capital employed with all parts of the business improving returns
  - Revenue and margin growth opportunities across both divisions

2021 ready | Quality of contract revenues is improving

→ **Group order book at £2.7bn (2019: £2.7bn), re-bid risk is reduced and focus is on improving quality/margin**



2021 ready | Good progress on material re-bids

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- → c. £240 million of annualised revenue expiring in 2020 and 2021 was scheduled to be rebid
- → Significant progress has been made despite some Covid-19 delays
- → Mears has a number of routes to maintaining existing relationships

Period of material contract rebids (Aug 19 – Dec 21)

Client	Period of material contract rebids	Original contract end date	Revised contract end date
Cross Keys	Extension	Sep-19	Mar-24
Rotherham BC	Win	Mar-20	Mar-25
Brighton	Negotiated	Mar-20	Mar-23
Crawley Homes	Win	Mar-20	Mar-24
East Kent Housing	Extension	Mar-20	Mar-23
North Lanarkshire	Negotiated	Jan-21	Mar-23
Lambeth	Extension / Rebid	Oct-20	Mar-21
Exeter City Council	Win	Dec-20	Dec-25
Milton Keynes	Extension	Mar-21	Mar-24
Tower Hamlets	Rebid	Mar-21	
Leeds	Rebid	Mar-21	

Good progress made on a number of material bids

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Cornwall Council
Win

Mears Group multi service contract

Exeter City Council
Win

Maintenance

MOD FDIS
Shortlisted

Management

North Lanarkshire
Process Paused

Mears Group multi service contract

Outlook

Outlook

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- **Maintenance**
  - Recovery in volumes, revenues and profitability expected to build through the second half of 2020
  - Contracts exited this year, plus slow build-back in tendering activity, will see a reduced run-rate in 2021 but focus on improved quality and margin
- **Management**
  - Demand to remain strong; AASC in core delivery phase with financials coming through on plan
  - Focus on key MoD tender
- **Group**
  - Continued de-leveraging from the unwind of Development projects and the disposal of Scotland Domiciliary Care
  - Strategic review of non-core asset portfolio

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