Smart Metering Systems plc
Annual report and accounts 2012

smart approach smart systems

smart metering
systems plc

Smart Metering Systems plc (SMS) connects, owns, operates and maintains metering systems and databases on behalf of major energy companies.

Our strategy is focused on gas meters in the UK, where we aim to:

- be the market leader in the independent ownership of industrial and commercial meters;
- establish our technology ADM™ as the industry standard smart metering solution for industrial and commercial (I & C) clients; and
- grow our domestic meters business organically and through new contracts.

Through our dedicated people we offer a unique integrated service to our clients and are looking to expand into other applications, including water and LPG, and other geographical markets where "smart" applications such as remote reading and half-hourly consumption data are important.

Read more about SMS online at our investor website **www.sms-plc.com**

Our highlights

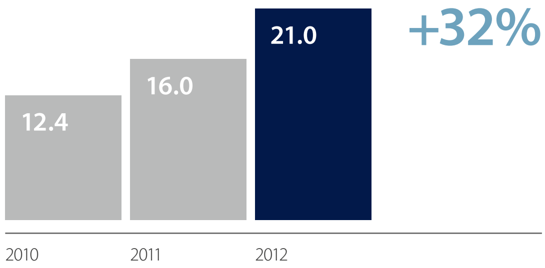
A year of growth across all sectors

FINANCIAL HIGHLIGHTS

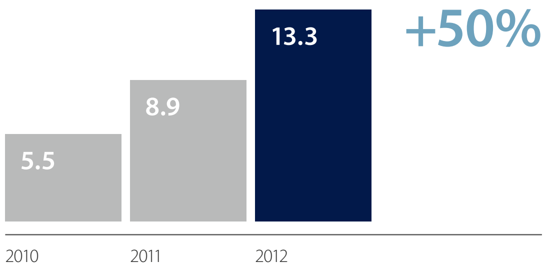
- Revenue increased by 32% to £21.0m (2011: £16.0m)
- Recurring meter rental increased by 40% to £9.3m (2011: £6.6m) representing 44% of total revenue
- Gross profit increased by 50% to £13.3m (2011: £8.9m)
- Gross profit margin increased by 8% to 63%
- Adjusted EBITDA* increased by 59% to £9.0m (2011: £5.7m)
- EBITDA margin increased by 7% to 43%
- Basic earnings per share increased by 77% to 5.18p (2011: 2.93p)
- Final dividend of 1.15p per ordinary share making 1.65p for the full year
- New banking club arrangement announced on 2 August 2012 for £45.0m with Barclays Bank PLC (lead bank), Clydesdale Bank PLC and Lloyds Bank PLC, replacing all existing facilities
- Available cash resources of £31.1m at 31 December 2012

* Excluding exceptional items and fair value adjustments.

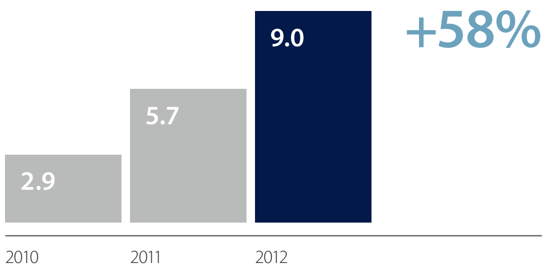
Revenue £m



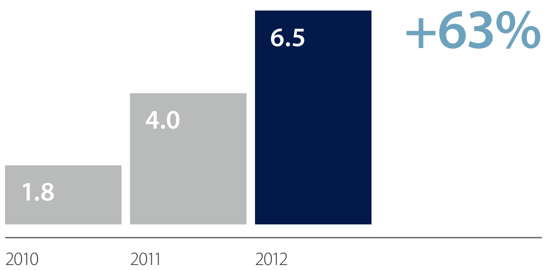
Gross profit £m



EBITDA* £m



EBT* £m



Overview
Business review
Corporate governance
Financial statements

Our business

OUR BUSINESS

With over 15 years' experience operating at the heart of the gas industry, we provide a comprehensive package of solutions encompassing all aspects of the gas connections and smart metering markets through our subsidiary companies:

GAS PRODUCER

LICENSED GAS TRANSPORTER

LICENSED GAS SUPPLIER AND SHIPPER

Gas suppliers arrange gas connections for their clients

Gas suppliers have an obligation to provide metering services

Gas suppliers are mandated to provide smart meter services

UK GAS CONNECTION

Infrastructure facilitator: management of gas connections and meter installations

UK Gas Connection is one of the UK's largest independent operators. We work in partnership with many of the leading providers in the UK gas industry to deliver meter installations, removals and exchanges, new gas supplies and increases in capacity.

UK METER ASSETS

Meter asset management: gas meter asset operations for every UK gas supplier

UK Meter Assets is an Ofgem accredited meter asset management company which owns, operates and manages commercial and domestic gas meters on behalf of the UK's leading gas suppliers and independent meter asset managers.

UK DATA MANAGEMENT

Smart meter data collector: supply and installation of smart meter devices

Smart metering is seen as the key to the future efficiency of the UK's energy system. UK Data Management delivers the Company's patented ADM™ smart metering solution which is very simple to install and highly cost effective and competitive. We strive to maintain our client centric culture and we focus on client needs, not product features.

Our strategy

DELIVERING ON OUR STRATEGY

2012 saw further delivery on our strategy with all major KPIs met across our business units.

Total meter portfolio increased by 34% to 341,000 (2011: 254,000) of which 95% are domestic, with substantial growth since half year (H1 2012: 283,275) and currently over 365,000

Increase of 74% in capital investment in meter assets to £16.0m (2011: £9.2m) an increase in average monthly run rate of meter installations to £1.3m investment in 2012 (2011: £0.76m)

Increase in annualised recurring meter rental revenue as at 31 December 2012 of 42% to £10.8m (2011: £7.6m) and at 28 February 2013 £11.5m

Significant new contracts

Gas suppliers

- Scottish and Southern Energy: c.180,000 domestic meters
- Scottish and Southern Energy: Initial order of 760 I & C meters and ADM™ devices
- Total Gas and Power: Initial quantity of 15,000 I & C meters and ADM™ devices
- Contract Natural Gas: Initial quantity of 1,475 I & C meters and ADM™ devices with exclusive arrangement to the balance of their portfolio estimated at over 20,000 I & C meters
- DONG Energy Sales for I & C meters and ADM™ devices
- E.ON Energy Solutions for gas metering services for both domestic and I & C sectors

Energy brokers: providers of brokerage services to small, medium and large group consumers

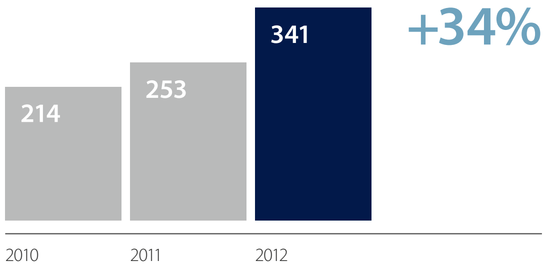
- BIU, Solis, Energi, Imserve and ISS for ADM™ devices and gas meters

ADM™

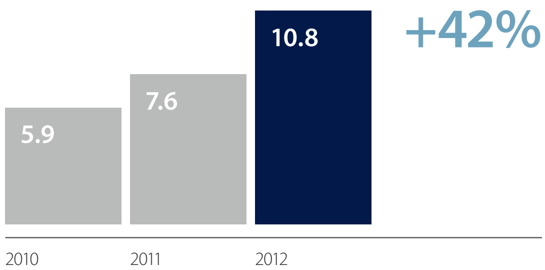
- First sales post-trial periods with a number of customers of over 2,000 units
- Trials commenced in the Water and LPG markets in the UK

Increase of 26% in Asset installation revenue to £11.8m (2011: £9.4m) of which Gas Connection business increased turnover by 10% to £6.5m (2011: £5.9m)

Total meter portfolio 000's



Annualised recurring revenue £m



Chairman's and Chief Executive Officer's statement

Kevin Lyon
Chairman and
Non-executive Director

Alan Foy
Chief Executive Officer

Highlights

- Substantial progress across all strategic areas
  - 34% increase in meter portfolio
  - Major new contracts signed:
    - 4 I & C
    - 2 Domestic
    - 5 energy brokers
- Contracts in place with over 80% of the total I & C market and over 40% of Domestic
- Basic earnings per share increased by 77%
- Final dividend of 1.15p per ordinary share

We are pleased to announce another strong set of results for the year ended 31 December 2012. The results reflect the cumulative effect of the increase in meters in 2011 and the increasing number of contracts signed during 2012.

OUR BUSINESS

Our business operation is based on connecting, owning, operating and maintaining metering systems and databases on behalf of major energy companies and energy brokers.

Our core focus is on gas meters in the UK, where we aim to:

— be the market leader in the independent ownership of industrial and commercial meters;

— establish ADM™ as the industry standard smart metering solution for Industrial and Commercial (I & C) clients; and

— grow our domestic meters business organically and potentially through new contracts.

We will also seek out new domestic and international markets for our products and services to widen our footprint in the UK and establish an international presence.

OPERATIONAL REVIEW

During 2012 we have made substantial progress in all three areas of our business. Following a strong first half where we saw our meter portfolio increase by 30,000, this accelerated substantially in the second half with a further 57,725 added leading to a 34% increase year-on-year in our gas meter portfolio. The progress we have made in establishing long-term recurring revenue was evidenced by an increase in year-end annualised recurring meter rental revenue of 42% to £10.8m and £42k data provision sales from our ADM™ device.

INDUSTRIAL AND COMMERCIAL METERS

During 2012 we were delighted to announce a number of major new contracts for the provision of gas meters within the I & C market with Contract Natural Gas, Total Gas and Power, DONG Energy Sales and E.ON Energy Solutions. The current estimates are for a total programme in excess of 22,000 meters to the end of 2014, of which over 2,000 had already been delivered by 31 December 2012.

In addition, SMS has also contracted with five energy brokers who provide brokerage and energy management services to small, medium and large group consumers for the provision of the ADM™ device and gas meters. The broker business is at present a small but growing part of our portfolio. The increase in customer base during 2012 now means that SMS has contracts in place with over 80% of the total I & C meter market.

Once installed, these meters will be on SMS's long-term index linked contracts and provide recurring revenue for the lifetime of the assets (expected to be 25 years).

The size of I & C meters is typically much greater than that of domestic meters and therefore the revenue per meter is substantially higher: the equivalent number of domestic meters for these 22,000 contracts would be in the order of 300,000.

Our transactional gas connections business continues to be cash generative and secure gas meter ownership for the Group; it has performed in line with management expectations.

ADM™

The ADM™ device is SMS's advanced metering solution which allows for remote meter reading on a half-hourly basis and has been designed in line with our own customer requirements. The ability of remote reading alongside SMS's full service capability in the I & C market provides a major opportunity for the Company in extending the service we offer and the ability to seek out further markets for our overall service. All new contracts announced in 2012 allow for the introduction of the ADM™ device into I & C premises during meter replacement programmes.

The large I & C market (estimated by SMS at greater than 300,000 meters) has to move to an advanced metering solution of which around 60,000 of the very large category have to be completed or contracted to be completed by 2014.

The small I & C market (estimated by SMS at over 1.2 million meters) has until 2014 to either opt for an advanced metering solution such as the ADM™ device or alternatively they can be included in the government's proposed domestic roll out of smart meters.

SMS believes that both market segments will find the ADM™ device an attractive solution, based on its competitive price and ease of installation.

The Company received full European Patent Approval for ADM™ in August and continues to progress the potential use of the ADM™ device in other sectors such as the UK's water and LPG industries where trials have commenced.

DOMESTIC METERS

SMS was successful during 2012 in obtaining two further contracts in the domestic market. In May SMS was contracted by SSE to provide Meter Operations Services in all regions outside of Scotland and the South East of England for two years. In November, a similar contract was agreed with E.ON Energy Solutions. The current estimate is that these two contracts will add a further c.180,000 units to the SMS meter portfolio over the lifetime of the contracts of which 90,000 have been delivered to date.

Significantly, the new agreement with SSE replaced an existing agreement that the customer had with the market leader in the domestic asset management business and marks a deepening of SMS's relationship with SSE.

Kevin Lyon
Chairman and
Non-executive Director

Alan Foy
Chief Executive Officer

Financial review

Glen Murray
Finance Director

Highlights

- Revenues increased by 32%
- Recurring revenue up 40%, representing 44% of total revenue
- Gross profit increased by 50%
- Adjusted EBITDA* increased by 59%
- Capital investment up by 74%
- New banking club arrangement announced on 2 August 2012 for £45.0m
- Available cash resources of £31.1m at the end of year

RESULTS FOR THE YEAR

During 2012, the Company increased revenue by 32% to £21.0m as a result of increasing meters under ownership and management and the contracted annual RPI increase. Recurring meter rental revenue, in line with the Company's strategy, increased to 44% of total revenue in 2012 compared to 41% in the same period in 2011.

Administration expenses, at £6.1m (excluding exceptional costs), were up 39% compared to 2011, substantially due to investment in staff numbers which have increased from 42 to 77 in line with the growth of the Company and its listed status and increased depreciation due to the increased meter base held by the Company.

Finance costs increased from £535k to £739k due to higher outstanding debt in the period as a result of the increase in meter investment.

Gross profit increased from £8.9m to £13.3m and adjusted EBITDA from £5.7m to £9.0m.

CASH AND BORROWINGS

As at 31 December 2012, the Company had debt of £20.4m compared to £11.2m in 2011, cash balances of £6.5m (2011: £7.3m), unused facilities of £24.6m and gearing of 85% (2011: 32%).

In August, SMS announced a new banking club arrangement with three major UK banks. The £45.0m facility with Barclays Bank PLC (lead bank), Clydesdale Bank PLC and Lloyds Bank PLC replaced the existing arrangement with Clydesdale Bank PLC. SMS intends to use the new facility to fund the purchase of meter assets during a phased installation over the course of the next 24 months in line with the recent substantial contract wins. Interest is paid quarterly at 2.9% plus three-month rolling LIBOR on the outstanding balance with drawn funds repaid equally over ten years. 1.45% is paid on undrawn funds. SMS has entered into a hedging arrangement to swap three-month rolling LIBOR, currently at c.0.51%, to a fixed 0.90–0.92% over four years for c.70% of the facility.

Net debt at 31 December 2012 was £13.9m (2011: £3.9m).

Capital investment in meters was £16.0m in 2012 compared to £9.2m in 2011.

TREASURY POLICIES

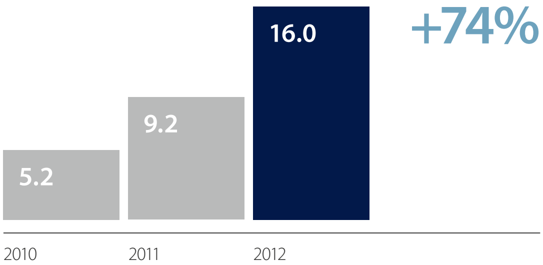
The Company uses interest rate swaps to manage interest rate fluctuations on interest-bearing loans and borrowings which means that the Company pays a fixed interest rate rather than being subject to fluctuations in the variable rate.

Interest rate swaps covered an amount of £13.2m as at 31 December 2012 (2011: £5.5m) and there was an interest rate cap over an amount of £Nil as at 31 December 2012 (2011: £5.5m).

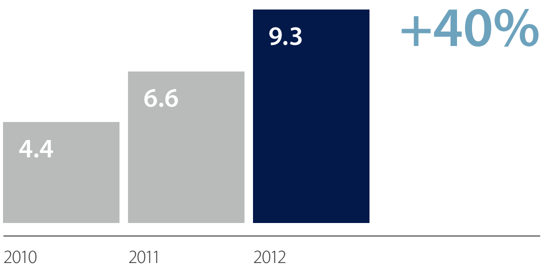
The interest rate swap results in a fixed interest rate of 0.90–0.92%. The termination date for the derivatives is 15 September 2016.

> "The Group realised sales of £21.0m during the year, a significant increase from the £16.0m realised during 2011."

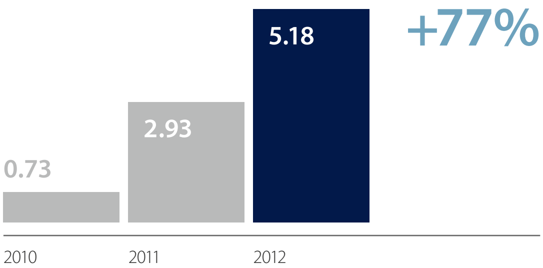
Capital investment £m



Recurring meter rental £m



Basic EPS pence



PEOPLE

During 2012 we continued to add to our management team and staff with the appointment of Derek Lithgow as Chief Operating Officer, Stan Chaloner as Group Sales Director and John Duke as Supply Chain Director, reflecting both the growth in the business and future opportunities. During the year SMS moved to larger premises in Glasgow following the expansion in staff numbers.

Steve Timoney, who founded the business in 1997 and has acted as Deputy Chairman since the Company's admission to AIM in 2010, has decided to retire from the business at the conclusion of the next Annual General Meeting (AGM). The Board wishes Steve all the best in his retirement and thanks him for the outstanding support he has given Alan Foy in his position as Chief Executive for the last five years. The Company will seek to recruit an additional Non-executive Director.

The most important part of our business is ensuring that we provide the highest quality of service to our customers, a value that continues to underpin the business. The results this year reflect the continued dedication of our staff in this endeavour and we would like to thank them for their continued support.

DIVIDEND

At the time of our admission to AIM, we stated that we intended to adopt a dividend policy that will take account of the Group's profitability, underlying growth prospects and availability of cash and distributable reserves, while maintaining an appropriate level of dividend cover.

SMS is therefore delighted to announce a proposed final cash dividend of 1.15p for the financial year ended 31 December 2012 to shareholders. In addition to the interim dividend of 0.5p this will make a full year distribution of 1.65p. The final dividend will be will be paid on 31 May 2013 to those shareholders on the register (record date) on 26 April 2013 with an ex-dividend date of 24 April 2013.

OUTLOOK

With further increases in recurring meter rental revenue as a result of contracts won in 2012, the increasing take up of the ADM™ device and the increased banking facilities agreed during 2012, we look forward again to a strong performance in 2013.

Glen Murray
Finance Director

Risk management

The attention of prospective investors is drawn to the fact that ownership of ordinary shares will involve a variety of risks which, if they occur, may have a materially adverse effect on the Group's business and financial condition and the market price of the ordinary shares could decline.

Risk	Description and mitigating actions
Failure of physical infrastructure or services of the Company	The Company operates with a well established IT support infrastructure which is fundamental to the smooth operation of our business. Service interruptions and equipment failures may expose the Company to financial loss and damage its reputation, which could have a material adverse effect on the Company's business, financial condition and results of operations. The Company's business includes the ownership and management of gas meters. If the Company fails to register a meter(s) on its IT system, wrongly classifies a meter or it loses track of a meter(s) within the system then this could also have a material adverse effect. The Company's IT infrastructure is subject to failure from a variety of causes largely outwith the Company's control, including human error, equipment failure, power loss, failure of services related to the internet and telecommunications provided by the Company, physical or electronic security breaches, as well as factors outwith the Company's control, such as sabotage, vandalism, system failures of network service providers, fire, earthquake, volcanic ash, flood and other natural disasters, water damage, fibre optic cable cuts, power loss not caused by the Company, improper building maintenance by the landlords of the buildings in which the IT infrastructure is located and terrorism. To mitigate against these risks the Company has deployed a fully redundant failover infrastructure which is mirrored in real time with all primary nodes. The mirrored servers are hosted on a secondary site at a Tier 1 data centre. A full business continuity plan is in place and is tested regularly. This plan facilitates the use of secondary office place which is fully equipped with computers, phones and other office equipment. Full disaster recovery failover to a new office environment can occur within four hours.
Dependency on key clients, terms of contracts, financing costs and performance levels	In its UKMA business, the Company is largely dependent on a small number of key gas suppliers with which it has entered into commercial contracts. Whilst there are termination provisions within such contracts which are designed to protect the Company in the short term, loss of one or more of these key clients could have a material adverse effect on the future growth of the Company's business. In addition, approximately 90% of the UKMA business revenue at the end of December 2012 was derived from consumers who are clients of suppliers which had contracted with the Company for meter asset management . The balance of the revenue was derived from consumers who had changed gas supplier to non-contracted suppliers. In the event that such non-contracted supplier used another MAM and management of the gas meter was changed to the new asset manager, then the Company would suffer a loss in revenue and would not benefit from the contract termination provisions outlined above. The key contracts with gas suppliers oblige the Company to fulfil certain performance obligations. In particular, the Company is required to provide meter assets for an agreed price. If the Company enters into such contracts on uneconomic terms or was unable to secure appropriate levels of asset finance on suitable terms then this would have a material adverse impact on the Company's business, financial condition and results of operations. In addition, should the Company be unable to meet an appropriate level of service in its UKGC business this may damage its reputation and could reduce the confidence of the Company's clients and users of its services, impairing its ability to retain existing clients and users and attract new clients and users. To mitigate against these risks the Company has now put in place full MAM service contracts that cover over 80% of the industrial and commercial market and over 40% of the domestic market and maintain strong relationships with the balance. These contracts ensure that either redemption penalties or recurring rentals will be payable on the vast majority of occasions where a meter point moves from one supplier to another. Strict service levels are monitored daily throughout all core business functions to ensure the Company meets and exceeds customer expectations.

Risk	Description and mitigating actions
Unforeseen delays and cost overruns when rolling out new and upgrading existing products and services	Management effort and financial resources are being employed by the Company in rolling out the ADM™ device. In addition, the Company periodically upgrades and replaces its IT infrastructure. Although the Company has budgeted for expected costings, additional expenses in the event of unforeseen delays, cost overruns, unanticipated expenses, regulatory changes and increases in the price of equipment may negatively affect the Company's business, financial condition and results of operations. The Company has considerable experience in forecasting and managing project implementation timetables. However, it may in the future experience unforeseen delays and expenses in connection with a particular project or initiative.
The Company may experience accelerated demand for its products and services	The Company expects to be able to meet its current capital expenditures from internal resources and debt facilities. In the event that the Company wins a large order for ADM™ devices and/or new smart meters then the Company may consider supporting the working capital requirements for such order(s) by way of an issue of new equity or debt finance or a combination of both. If the Company is unable to raise the necessary financing it could adversely affect the Company's ability to expand its business. The Company also maintains close relationships with funding partners to give the Directors confidence future growth can be funded.
The Company could be subject to increased operating costs, as well as claims, litigation or other potential liabilities, in connection with the security and control of the Company's systems and the personal data of users	The Company relies on systems and personnel in the Company's locations to physically secure IT infrastructure and user data. Any accidental or intentional actions, including computer viruses and unauthorised access, as well as other disruptions could result in increased operating costs or claims. The Company may incur significant additional costs to protect against such disruptions, the threat of security breaches (whether physical or electronic) or to alleviate problems caused by such interruptions or breaches. Smart Metering Systems plc is forging a strong reputation for reliable secure IT systems. Our IT systems are designed to be highly resilient against the most serious levels of disruption. Disaster recovery facilities are in place to provide a fully functional alternate location for operations with access to all production data. All production data is backed up live (24/7) to a highly secure offsite facility. Disaster events from fire, communications failures, etc are planned for and solutions are tested. Business continuity insurance is in place to provide protection against costs of such events. A party who is able to breach the physical premises and/or electronic security measures of the Company's systems could damage the Company's equipment and/or misappropriate either its proprietary information or the personal information of the Company's users and cause interruptions or malfunctions in its operations. If a third party were able to misappropriate data held on the Company's system then the Company could be subject to claims, litigation or other potential liabilities. Whilst security remains one of the Company's highest priorities, there can be no certainty that the security of its systems will not be breached and the information of the Company's clients and customers put at risk. Any security breach (whether physical or electronic) could have a serious effect on the Company's reputation and could lead to a loss of clients and/or existing clients seeking to claim damages. This could have a material adverse effect on the Company's business, financial condition and result of operations or future growth.
If the Group is not able to effectively manage its growth, its operations could be damaged and profitability reduced	The Group's business and operations have experienced rapid growth. If the Group fails to effectively manage this growth in the future, its operations could be harmed. This future growth could place significant demands on the Group's operational and financial infrastructure. If the Group is unable to effectively manage its growth its operations could be harmed and profitability reduced. The growth of the Group's sales and profits in the future will depend, in part, on its ability to expand its operation through the roll out of new products, the exchange of existing gas meters and the launching of its services into new markets and geographies. Furthermore, in order to manage its planned expansion, it will need to continually evaluate the adequacy of its management capability, operational procedures, financial controls and information systems. Accordingly, there can be no assurance that the Group will be able to achieve its expansion goals on a timely or profitable basis.

Board of directors

Kevin Lyon
Non-executive Chairman

A qualified chartered accountant, Kevin spent two years in merchant banking before joining the UK's leading private equity business, 3i plc. In a 17 year career with 3i, Kevin led transactions in a wide range of sectors and held a number of leadership and management positions including latterly managing director at UK Private Equity. He left in 2004 and, since then, he has served as an independent chairman or non-executive director on a number of boards across a wide range of sectors. Kevin is currently chairman of both AIM-quoted Valiant Petroleum plc and Mono Global Group and also serves as an independent director of DCK Concessions. He was chair of the audit committee and senior independent director of Booker plc, a £4bn revenue wholesale cash and carry business, when it floated on AIM in June 2007. He graduated from Edinburgh University in 1982 and has attended Management and Business Development courses at INSEAD, IESE and Ashridge.

Steve Timoney
Deputy Chairman

Steve founded the Company in 1995. Prior to starting the business, he spent 14 years with British Gas Transco (now NGT) working within the engineering function with specific responsibility for gas pipelines and meter assets. He then moved on to work for Shell UK as Commercial Manager (Scotland) responsible for all commercial aspects of the marketing of natural gas to consumers. Steve became the recognised expert on contract development under the Network Code regime and was also responsible for setting up systems and procedures for the management of gas connection projects. Steve is a professional engineer and also has a Masters Degree in Corporate Leadership, studying both at Emory University, Atlanta and Napier University, Edinburgh, graduating with distinction in 2006.

Alan Foy
Chief Executive Officer

Alan has responsibility for business growth, client management and business operations. Prior to joining SMS in 2004, Alan worked for Scottish Power 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 independent gas transporter in the UK. He gained considerable experience in utility asset ownership, as well as supply and shipping activities. Working within very complex and regulated frameworks, his position required a full understanding of utility business activities such as customer recruitment, licensing, regulation, safety, commercial, IT, investment and financial policies. Prior to this Alan was a director of an international energy consultancy practice specialising in energy utilisation and design.

In addition to adding valuable experience to the overall business, during his tenure with SMS Alan has successfully implemented a restructuring and systemising of the Company's activities, as well as successfully gaining and retaining new clients and contracts. A professionally qualified engineer, Alan places strong emphasis on safety, operational performance and financial accountability. He also places great importance on training of staff members to ensure they are receptive and adaptable to business needs and operate to a high level of efficiency and customer satisfaction.

Glen Murray
Finance Director

Glen joined SMS in 2009 as a business accountant prior to assuming his current role as Finance Director. A qualified accountant and experienced financier, he provides the business with the structure and controls to diligently manage and report on all business activities. Glen has key responsibility for financial reporting, business plan modelling and business performance monitoring and reporting against the plan. Glen qualified with French Duncan in 1995 and in 1997 joined Shin-Etsu Handotai Europe as an accountant, with responsibilities including treasury management, budgetary control, monthly branch accounts and management accounting. He later joined Gilchrist & Company (which merged with Baker Tilly in May 2009) as a senior manager responsible for a team of five delivering accountancy, audit, corporate finance and VAT services.

Nigel Christie
Non-executive Director

Nigel has served in various management positions within corporate finance departments of investment banking firms. He began his career in 1976 at Kleinwort Benson, working in both London and New York. From 1985 to 1989, he was a managing director in the corporate finance department of S.G. Warburg, New York. Between 1989 and 1991, Nigel served as managing director of the corporate finance department of Kidder, Peabody International where he was responsible for overseeing European mergers and acquisitions. From 1991 to 1995, Nigel was a director of MacArthur & Co. Limited, following which he worked for Columbus Asset Management between 1995 and 1999 and Value Investing Partners, Inc. between 1999 and 2000. From 2000 to 2012, he was a director of RP&C International, an investment banking firm providing specialist advisory services to public and private companies. Amongst other directorships, Nigel currently serves as chairman of AIM-quoted Maple Energy plc and is a member of Maple Energy plc's audit committee on which he acts as chairman. He graduated from the University of St. Andrews in Scotland and attended the Program for Management Development at Harvard Business School.

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 2012.

PRINCIPAL ACTIVITIES

The principal activity of the Group during the year was that of rental and management of gas meters and that of laying infrastructure pipes for industrial and commercial premises and the provision of specialist technical advice on the use and management of energy for industrial and commercial users.

The subsidiary undertakings principally affecting the profits and net assets of the Group in the year are listed in note 2 to the parent company financial statements.

REVIEW OF THE BUSINESS

The Company is required by section 417 of the Companies Act to set out in this report a fair review of the business and future developments of the Group during the financial year ended 31 December 2012 and of the position of the Group at the end of the year. This information can be found in the Chairman's Statement and Chief Executive's Review on pages 4 to 5.

Information on the use of financial instruments by the Group is given in note 18 to the financial statements.

DIRECTORS

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

Name of Director	Board title	Date of appointment
K J Lyon	Non-executive Chairman	27 May 2011
N B Christie	Independent Non-executive Director	27 May 2011
A H Foy	Chief Executive	24 December 2009
S P Timoney	Deputy Chairman	24 December 2009
G Murray	Finance Director	1 January 2011

CHARITABLE AND POLITICAL DONATIONS

During the year the Group made charitable donations of £1,800 (2011: £3,450) and sponsorship payments of £Nil (2011: £9,338).

No political donations were made during the year (2011: Nil).

SUPPLIER PAYMENT POLICY

The Group's policy is to meet obligations promptly on agreed payment dates, unless there is an unresolved query or dispute over the sum due. Trade creditors of the Group at 31 December 2012 were equivalent to 36 (2011: 30) days purchases, based on the average daily amount invoiced by suppliers during the year.

SUBSTANTIAL SHAREHOLDINGS

On 1 February 2013, the Company had been notified, in accordance with sections 791 to 828 of the Companies Act, of the following interest in the ordinary share capital of the Company:

Name of holder	Number	% held
S P Timoney	23,144,344	27.77%
A H Foy	8,889,958	10.67%
Cazenove Capital Management	7,723,500	9.27%
Liontrust Asset Management	6,904,974	8.29%
Old Mutual Asset Managers (UK)	5,439,047	6.53%
Legal & General Investment Management	4,801,308	5.76%
Investec Asset Management	4,000,000	4.80%

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 ought to have taken as a Director in order to make himself 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.

Baker Tilly UK Audit LLP have expressed their willingness to continue in office as auditor and a resolution to re-appoint Baker Tilly Audit UK LLP will be proposed at the forthcoming AGM.

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

Glen Murray
Company secretary
20 March 2013

Corporate governance statement

The Company complies, so far as is practicable and appropriate for a company of its size and nature, with the provisions of the Corporate Governance Code, as modified by the recommendations of the Quoted Companies Alliance (QCA).

BOARD STRUCTURE

During the year the Company had two Independent Non-executive Directors on the Board to bring an independent view and to provide a balance to the Executive Directors.

The Board is responsible for formulating, reviewing and approving the Group's strategy, budgets and corporate actions. The Directors intend to hold monthly Board meetings.

BOARD COMMITTEES

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

AUDIT COMMITTEE

During the year the Audit Committee comprised Nigel Christie (Chair) and Kevin Lyon. Meetings are also attended, by invitation, by the Group Finance Director. The Audit Committee is responsible for monitoring the quality of internal controls and ensuring that the financial performance of the Group is properly measured and reported on. It receives and reviews reports from the Group's management and external auditor relating to the interim and annual accounts and the accounting and internal control systems in use throughout the Group. The Audit Committee meets at least twice in each financial year and has unrestricted access to the Group's external auditor.

REMUNERATION COMMITTEE

During the year the Remuneration Committee comprised Kevin Lyon (Chair) and Nigel Christie. 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. The Remuneration Committee meets at least annually. In exercising this role, the Directors have regard to the recommendations put forward in the QCA Guidelines and, where appropriate, the Corporate Governance Code guidelines.

NOMINATION COMMITTEE

During the year the Nomination Committee consisted of a committee chaired by Kevin Lyon and also comprising Nigel Christie and Alan Foy. The Nomination Committee considers the selection and re-appointment of Directors. It identifies and nominates candidates to fill Board vacancies and reviews regularly 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.

INTERNAL CONTROL

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

The Board are of the view that due to the current size and composition of the Group, it is not necessary to establish an internal audit function.

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 Annual General Meeting at which the Chairman presents a review of the results and comments on current business activity. The Chairmen of the Audit and Remuneration Committees will be available at the Annual General Meeting to answer any shareholder questions.

Notice of the Annual General Meeting will be issued in due course.

GOING CONCERN

The Directors confirm that, having given consideration to various alternative outcomes of future performance together with the available bank facilities, they are satisfied that the Company and 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.

Directors' remuneration report

As an AIM Company, Smart Metering Systems plc is required to comply with Schedule 8 to the Large and Medium sized Companies and Groups (Accounts and Report) Regulations 2008. The content of this report is unaudited unless stated.

REMUNERATION COMMITTEE

The Remuneration Committee comprises the Non-executive Chairman (Kevin Lyon) and Independent Non-executive Director (Nigel Christie).

The Remuneration Committee reviews the performance of the Executive Directors and makes recommendations to the Board on matters relating to remuneration, terms of service, granting of share options and other equity incentives.

The Remuneration Committee meets at least annually.

REMUNERATION POLICY

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

NON-EXECUTIVE DIRECTORS

Remuneration of the Non-executive Directors, including the Chairman, is determined by the Executive Directors. Non-executive Directors are not entitled to pensions, annual bonuses or employee benefits. They are entitled to participate in share option arrangements relating to the Company's shares. Each of the Non-executive Directors has a letter of appointment stating his annual fee and that his appointment is initially for a term of three years. Their appointment may be terminated with three months' written notice at any time.

DIRECTORS' REMUNERATION

The normal remuneration arrangements for Executive Directors consist of Directors' fees, basic salary and annual performance related bonuses.

In addition, they receive private health care, permanent health insurance and pension contributions.

DIRECTORS' EMOLUMENTS

	Fees/ basic salary £	Bonus £	Pension contribution £	Benefits in kind £	**2012 Total £**	2011 Total £
Executive						
S P Timoney	—	—	1,000	7,026	**8,026**	207,383
A H Foy	300,000	50,000	13,000	6,578	**369,578**	328,622
G Murray	75,000	15,000	3,750	1,403	**95,153**	84,575
Non-executive						
K J Lyon	78,000	—	—	—	**78,000**	50,000
N B Christie	49,920	—	—	—	**49,920**	32,000
T E Allison	—	—	—	—	**—**	150,000
P D Gregory	—	—	—	—	**—**	50,000
B Wilson	—	—	—	—	**—**	50,000
Total	502,920	65,000	17,750	15,007	**600,677**	952,580

Directors' remuneration report continued

DIRECTORS' INTERESTS

The Directors who held office at 31 December 2012 had the following interests in the shares of the Company:

	Ordinary shares	
	£0.01p each 2012	£0.01p each 2011
Executive		
S P Timoney	**23,144,344**	25,004,810
A H Foy	**8,889,958**	13,334,937
G Murray	**—**	—
Non-executive		
K J Lyon	**125,000**	125,000
N B Christie	**80,000**	80,000
	32,239,302	38,544,747

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:

Options granted are summarised below:

	Type	Number of shares under option	Exercise price	Date of grant	Earliest date exercisable
Executive					
G Murray	Approved	39,474	76p	15/07/11	15/07/14
	Unapproved	666,667	60p	20/06/11	20/06/16
Non-executive					
K J Lyon	Unapproved	437,500	60p	20/06/11	20/06/12*
N B Christie	Unapproved	280,000	60p	20/06/11	20/06/12*

* Only 50% of the options can be exercised at this date.

The share price at 31 December 2012 was 238p. The range in the period 8 July to 31 December 2012 was 90p to 258p.

Details of share options granted by the Company at 31 December 2012 are given in note 23.

Directors' responsibilities statement

In the preparation of financial statements

The Directors are responsible for preparing the Directors' 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 (IFRS) 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).

The Group financial statements are required by law and IFRS 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:

a. select suitable accounting policies and then apply them consistently;

b. make judgements and accounting estimates that are reasonable and prudent;

c. for the Group financial statements, state whether they have been prepared in accordance with IFRS 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

d. 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.

Independent auditor's report

To the members of Smart Metering Systems plc

We have audited the Group and parent company financial statements (the financial statements) on pages 19 to 44. 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) 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 (United Kingdom Generally Accepted Accounting Practice).

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.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As more fully explained in the Directors' Responsibilities Statement on page 17, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

OPINION ON FINANCIAL STATEMENTS

In our opinion:

— 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 2012 and of the Group's profit for the year then ended;

— the Group financial statements have been properly prepared in accordance with IFRS 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 and as regards the Group financial statements, Article 4 of the IAS regulation.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where 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.

Alan Aitchison (Senior Statutory Auditor)
For and on behalf of BAKER TILLY UK AUDIT LLP, Statutory Auditor
Chartered Accountants
Breckenridge House
274 Sauchiehall Street
Glasgow G2 3EH
20 March 2013

Consolidated statement of comprehensive income

For the year ended 31 December 2012

	Notes	2012 £'000	2011 £'000
Revenue	1	**21,029**	15,964
Cost of sales	2	**(7,759)**	(7,109)
Gross profit		**13,270**	8,855
Administrative expenses	2	**(7,337)**	(5,050)
Profit from operations	2	**5,933**	3,805
Attributable to:			
Operating profit before exceptional items		**7,176**	4,482
Exceptional items and fair value adjustments	2	**(1,243)**	(677)
Finance costs	5	**(739)**	(535)
Finance income	5	**33**	41
Profit before taxation		**5,227**	3,311
Taxation	6	**(914)**	(1,121)
Profit for the year attributable to equity holders		**4,313**	2,190
Other comprehensive income		**—**	—
Total comprehensive income		**4,313**	2,190

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

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

	Notes	2012	2011
Basic earnings per share (pence)	7	**5.18**	2.93
Diluted earnings per share (pence)	7	**5.00**	2.90

Consolidated statement of financial position

As at 31 December 2012

	Notes	2012 £'000	2011 £'000
Assets			
Non-current			
Intangible assets	9	**1,916**	1,885
Property, plant and equipment	10	**36,104**	21,327
		38,020	23,212
Current assets			
Inventories	12	**373**	83
Trade and other receivables	13	**3,091**	1,606
Cash and cash equivalents	14	**6,455**	7,317
Other current financial assets	18	**—**	18
		9,919	9,024
Total assets		**47,939**	32,236
Liabilities			
Current liabilities			
Trade and other payables	15	**8,201**	6,379
Bank loans and overdrafts	16	**2,150**	1,328
Commitments under hire purchase agreements	17	**3**	3
Other current financial liabilities	18	**170**	339
		10,524	8,049
Non-current liabilities			
Bank loans	16	**18,299**	9,845
Obligations under hire purchase agreements	17	**10**	13
Deferred tax liabilities	20	**2,510**	1,873
		20,819	11,731
Total liabilities		**31,343**	19,780
Net assets		**16,596**	12,456
Equity			
Share capital	22	**833**	833
Share premium		**8,653**	8,653
Other reserve	24	**1**	1
Retained earnings		**7,109**	2,969
Total equity attributable to equity holders of the parent company		**16,596**	12,456

The financial statements on pages 19 to 44 were approved and authorised for issue by the Board of Directors and signed on its behalf by:

Glen Murray
Director
20 March 2013

Company Registration Number
SC367563

Consolidated statement of changes in equity

For the year ended 31 December 2012

Attributable to the owners of the parent company:	Share capital £'000	Share premium £'000	Other reserve £'000	Retained earnings £'000	Total £'000
As at 1 January 2011	—	—	1	1,526	1,527
Profit for the year	—	—	—	2,190	2,190
Transactions with owners in their capacity as owners:					
Share bonus issue (Note 22)	666	—	—	(666)	—
Shares issued (Note 22)	167	9,833	—	—	10,000
Share issue costs	—	(1,180)	—	—	(1,180)
Dividends (Note 8)	—	—	—	(180)	(180)
Share options	—	—	—	99	99
As at 31 December 2011	833	8,653	1	2,969	12,456
Profit for the year	—	—	—	4,313	4,313
Transactions with owners in their capacity as owners:					
Dividends (Note 8)	—	—	—	(417)	(417)
Share options	—	—	—	244	244
As at 31 December 2012	833	8,653	1	7,109	16,596

Consolidated statement of cash flows

For the year ended 31 December 2012

	2012 £'000	2011 £'000
Cash flow from operating activities		
Profit before taxation	5,227	3,311
Finance costs	739	535
Finance income	(33)	(41)
Fair value movement on derivatives	(151)	249
Depreciation	1,599	956
Amortisation	238	234
Share-based payment expense	244	99
Increase in inventories	(290)	(83)
Increase in trade and other receivables	(1,485)	(438)
Decrease in trade and other payables	1,835	128
Cash generated from operations	7,923	4,950
Taxation	(290)	—
Net cash generated from operations	7,633	4,950
Investing activities		
Payments to acquire property, plant and equipment	(16,380)	(9,332)
Disposal of property, plant and equipment	4	180
Payments to acquire intangible assets	(269)	(388)
Finance income	33	41
Net cash used in investing activities	(16,612)	(9,499)
Financing activities		
New borrowings	10,947	3,148
Capital repaid	(1,671)	(1,211)
Net outflow from other long-term creditors	(3)	—
Finance costs	(739)	(535)
Net proceeds from share issue	—	8,820
Dividend paid	(417)	(180)
Net cash generated from financing activities	8,117	10,042
Net increase in cash and cash equivalents	(862)	5,493
Cash and cash equivalents at the beginning of the financial year	7,317	1,824
Cash and cash equivalents at the end of the financial year (note 14)	6,455	7,317

Accounting policies

The Company is incorporated and domiciled in the UK. The Group's activities consist of the rental and management of gas meters and that of laying infrastructure pipes for industrial and commercial premises and the provision of specialist technical advice on the use and management of energy for industrial and commercial users.

BASIS OF PREPARATION

The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments which are measured at fair value in line with applicable accounting standards. The consolidated financial statements are presented in British pounds Sterling (£), which is also the functional currency of the Group, 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 which extend to July 2014 and available cash resources at 31 December 2012 of £31.1m.

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 financial statements incorporate the consolidated financial statements of the Company and all Group undertakings being UK Gas Connection Limited, UK Meter Assets Limited, UKMA (AF) Limited and UK Data Management Limited. These are adjusted, where appropriate, to conform to Group accounting policies and are prepared to the same accounting reference date. The Company was incorporated on 27 October 2009. The Group was formed on 24 December 2009 through the acquisition of the entire share capital of UK Gas Connection Limited and UK Meter Assets Limited (the only subsidiaries in existence at that time).

Whilst the Group was newly formed, the ultimate ownership of all companies remained unchanged and, as such, the financial statements have been prepared based on a reconstruction under common control, reflecting the Group results for the current and prior years as though the Group structure has always existed.

USE OF ESTIMATES AND JUDGEMENTS

The preparation of the financial statements requires the use of estimates and assumptions. Although these estimates are based on management's best knowledge, actual results ultimately may differ from these estimates.

The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are the estimation of share-based payment costs. The estimation of share-based payment costs requires the selection of an appropriate valuation model, consideration as to the inputs necessary for the valuation model chosen and the estimation of the number of awards that will ultimately vest, inputs for which arise from judgements relating to the probability of meeting non-market performance conditions and the continuing participation of employees.

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, 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 Company fulfils its contractual obligations to customers by supplying services, or when they have the right to receive the income.

METER RENTAL INCOME

Rental income is recognised when the Company is contractually entitled to it. Rental income is calculated on a daily basis and invoiced monthly. Rental contracts do not operate on a fixed term basis.

GAS CONNECTION

Revenue from gas connection contracts is recognised upon delivery of the related service, in line with our contractual entitlement.

DATA MANAGEMENT

Data provision income is recognised when the Company is contractually entitled to it. Data provision income is invoiced in advance and is recognised in a straight line over the contract period.

Accounting policies continued

SEGMENT REPORTING

An operating segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. Operating segments are reported in a manner consistent with the reports made to the chief operating decision maker which are consistent with the reported results.

The Company considers that the role of chief operating decision maker is performed by the Board of Directors.

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, available-for-sale financial assets or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

The Group's financial assets include cash and short-term deposits, trade and other receivables, loans and other receivables, quoted and unquoted financial instruments and derivative financial instruments.

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, loans and borrowings or as derivatives designated as hedging instruments in an effective hedge, 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 overdraft, loans and borrowings, financial guarantee contracts and derivative financial instruments.

DERECOGNITION

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability and the difference in the respective carrying amounts is recognised in the income statement.

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 uses 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.

CURRENT VERSUS NON-CURRENT CLASSIFICATION

Derivative instruments that are not designated as effective hedging instruments are classified as current or non-current or separated into a current and non-current portion based on an assessment of the facts and circumstances (i.e. the underlying contracted cash flows).

Where the Group will hold a derivative as an economic hedge (and does not apply hedge accounting) for a period beyond twelve months after the reporting date, the derivative is classified as non-current (or separated into current and non-current portions) consistent with the classification of the underlying item.

Derivative instruments that are designated as, and are effective hedging instruments, are classified consistent with the classification of the underlying hedged item. The derivative instrument is separated into a current portion and non-current portion only if a reliable allocation can be made.

EXCEPTIONAL ITEMS

The Group presents as exceptional items on the face of the income statement 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.

RESEARCH AND DEVELOPMENT

Expenditure on pure and applied research activities is recognised in the income statement 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, 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 commercialised or in 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	20% 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 net operating expenses disclosed in the statement of comprehensive income.

Intangible assets are amortised over their useful lives as follows:

Software	12.5% straight line

Useful lives are also examined on an annual basis and adjustments, where applicable, are made on a prospective basis. The Company does not have any intangible assets with indefinite lives.

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 and borrowing costs for long-term construction projects if the recognition criteria are met. 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.

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

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

Short leasehold property	20% on cost
Plant and machinery	5% on cost
Fixtures and fittings	15% on cost
Equipment	33% on cost

Land is not depreciated.

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 income statement 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.

All fixed assets are initially recorded at cost.

Accounting policies continued

IMPAIRMENT OF ASSETS

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For purposes of assessing impairment assets that do not individually generate cash flows are assessed as part of the cash-generating unit to which they belong. Cash-generating units are the lowest levels for which there are cash flows that are largely independent of the cash flows from other assets or groups of assets.

INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Costs comprise 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 balance sheet comprise 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 consist 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 tangible fixed assets at their fair value. The capital element of the future payments is treated as a liability and the notional interest is charged to the statement of comprehensive income in proportion to the remaining balance outstanding.

LEASED ASSETS AND OBLIGATIONS

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the commencement of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised in the income statement. Leased assets are depreciated over the useful life of the asset. However, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term. Operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

All other leases are operating leases and the annual rentals are charged to the statement of comprehensive income on a straight line basis over the lease term.

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 statement of comprehensive income.

SHARE-BASED PAYMENTS

The costs of equity-settled share-based payments are charged to the income statement over the vesting period. The charge is based on the fair value of the equity instrument granted and the number of equity instruments that are expected to vest.

TAXATION

Tax currently payable is based on the taxable profit for the year. Taxable profit differs from accounting profit as reported in the 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.

ADOPTION OF THE INTERNATIONAL ACCOUNTING STANDARDS

NEW STANDARDS, AMENDMENTS AND INTERPRETATIONS ISSUED BUT NOT EFFECTIVE FOR THE FINANCIAL YEAR BEGINNING 1 JANUARY 2013 AND NOT EARLY ADOPTED

Standard	Key requirements	Effective date
IFRS 1, Government Loans	The amendments provide relief to first-time adopters of IFRS by allowing prospective application of IFRS 9 or IAS 39 and paragraph 10A of IAS 20 to government loans outstanding at the transition to IFRS.	1 January 2013
IFRS 7, Financial Instruments: Offsetting Financial Assets and Financial Liabilities'	The amendments require entities to disclose information about the rights of offset and related arrangements for financial instruments under an enforceable master netting agreement or similar agreement.	1 January 2013
IFRS 9, Financial Instruments	The standard is the first standard issued as part of a wider project to replace IAS 39. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The classification depends on the entity's business model and the contractual cash flow characteristics of the instrument. The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply.	1 January 2015
IFRS 10, Consolidated financial statements	The standard's objective is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. It builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess.	1 January 2014
IFRS 11, Joint arrangements	IFRS 11 is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangement: joint operations and joint ventures. Proportional consolidation of joint ventures is no longer allowed.	1 January 2014
IFRS 12, Disclosures of interests in other entities	IFRS 12 includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles.	1 January 2014
IFRS 13, Fair value measurement	IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS.	1 January 2014
Amendment to IAS 1, Financial statement presentation regarding other comprehensive income	The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI.	1 July 2012
Amendment to IAS 19, Employee benefits	These amendments eliminate the corridor approach and calculate finance costs on a net funding basis.	1 January 2013
IAS 27 (revised 2011), Separate financial statements	IAS 27 (revised 2011) includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10.	1 January 2013
IAS 28 (revised 2011), Associates and joint ventures	IAS 28 (revised 2011) includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11.	1 January 2014
IAS 32, Offsetting Financial Assets and Financial Liabilities	The amendments clarify existing application issues relating to the offsetting requirements.	1 January 2014

There are no other IFRS or IFRIC interpretations that are not yet effective that would be expected to have a material impact on Smart Metering Systems plc.

None of the above interpretations would have an impact on this financial information if applied.

Notes to the financial statements

For the year ended 31 December 2012

1 SEGMENTAL REPORTING

For management purposes, the Group is organised into two core divisions, management of assets and installation of meters, which form the basis of the Group's reportable operating segments. 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:

The management of assets comprises regulated management of gas meters within the UK.

The installation of meters comprises installation of domestic and industrial and commercial gas meters throughout the UK.

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 or loss excluding operating costs not reported by segment, depreciation, amortisation of intangible assets and exceptional items.

The following tables present information regarding the Group's reportable segments for the years ended 31 December 2012 and 31 December 2011:

31 December 2012	Asset management £'000	Asset installation £'000	Unallocated £'000	Total operations £'000
Segment/Group revenue	9,254	11,775	—	21,029
Operating costs	(2,194)	(5,565)	—	(7,759)
Segment profit – Group gross profit	7,060	6,210	—	13,270
Items not reported by segment:				
Other operating costs	—	—	(4,266)	(4,266)
Depreciation	(918)	—	(672)	(1,590)
Amortisation	(238)	—	—	(238)
Exceptional items and fair value adjustments	—	—	(1,243)	(1,243)
Profit before interest and tax	5,904	6,210	(6,181)	5,933
Net finance costs	—	—	(706)	(706)
Profit before tax	5,904	6,210	(6,887)	5,227
Tax expense				(914)
Profit for year				4,313

31 December 2011	Asset management £'000	Asset installation £'000	Unallocated £'000	Total operations £'000
Segment/Group revenue	6,614	9,350	—	15,964
Cost of sales	(1,973)	(5,136)	—	(7,109)
Segment profit – Group gross profit	4,641	4,214	—	8,855
Items not reported by segment:				
Other operating costs	—	—	(3,182)	(3,182)
Depreciation	(918)	—	(38)	(956)
Amortisation	(235)	—	—	(235)
Exceptional items and fair value adjustments	—	—	(677)	(677)
Profit before interest and tax	3,488	4,214	(3,897)	3,805
Net finance costs	—	—	(494)	(494)
Profit before tax	3,488	4,214	(4,391)	3,311
Tax expense				(1,121)
Profit for year				(2,190)

All revenues and operations are based and generated in the UK.

1 SEGMENTAL REPORTING CONTINUED

The Group has one major customer that generated turnover within each segment as listed below:

	2012 £'000	2011 £'000
Customer 1 – Asset Management	**5,511**	4,380
Customer 1 – Asset Installation	**4,228**	2,860
	9,739	7,240

No segmentation is presented for the majority of Group assets and liabilities as these are managed centrally, independently of operating segments.

Those assets and liabilities that are managed and reported on a segmental basis are detailed below.

SEGMENT ASSETS AND LIABILITIES

31 December 2012	**Asset management £'000**	**Asset installation £'000**	**Total operations £'000**
Assets reported by segment			
Intangible assets	**1,916**	**—**	**1,916**
Plant and machinery	**35,791**	**—**	**35,791**
Inventories	**373**	**—**	**373**
			38,080
Assets not reported by segment			**9,859**
Total assets			**47,939**
Liabilities reported by segment			
Obligations under hire purchase agreements	**13**	**—**	**13**
			13
Liabilities not reported by segment			**31,333**
Total liabilities			**31,346**

31 December 2011	Asset management £'000	Asset installation £'000	Total operations £'000
Assets reported by segment			
Intangible assets	1,885	—	1,885
Plant and machinery	21,125	—	21,125
Inventories	83	—	83
			23,093
Assets not reported by segment			9,143
Total assets			32,236
Liabilities reported by segment			
Obligations under hire purchase agreements	16	—	16
			16
Liabilities not reported by segment			19,764
Total liabilities			19,780

Notes to the financial statements continued

For the year ended 31 December 2012

2 INCOME STATEMENT BY NATURE AND ITEMS OF EXPENDITURE INCLUDED IN THE CONSOLIDATED INCOME STATEMENT

	2012 £'000	2011 £'000
Revenue	**21,029**	15,964
Direct rental costs	**(2,194)**	(1,973)
Direct subcontractor costs	**(4,556)**	(4,437)
Other direct sales costs and systems rental	**(1,001)**	(699)
Staff costs	**(2,665)**	(1,965)
Depreciation:		
– owned assets	**(1,568)**	(948)
– leased assets	**(31)**	(8)
Amortisation	**(238)**	(234)
Auditor's remuneration:		
– as auditor	**(43)**	(59)
– other services	**(22)**	(188)
Exceptional costs	**(1,243)**	(677)
Operating lease costs:		
– plant and equipment	**(30)**	(25)
Other operating charges	**(1,505)**	(946)
Operating profit	**5,933**	3,805
Finance costs	**(739)**	(535)
Finance income	**33**	41
Profit before taxation	**5,227**	3,311

Included in exceptional items and fair value adjustments expenses are: i) £Nil (2011: £329,000) that relates to costs incurred during the listing process; ii) £(151,000) (2011: £249,000) relates to the interest rate hedge fair value adjustment; iii) £652,518 (2011: £Nil) of costs associated with restructuring debt facilities; iv) £395,300 (2011: £Nil) settlement of hedge; v) £243,675 (2011: £99,000) that relates to share-based payments; and vi) £102,650 (2011: £Nil) TUPE costs relating to a contract win during the year.

Amounts paid to our auditor during the year totalled £65,480 (2011: £247,000).

This can be analysed as:

	2012 £'000	2011 £'000
Statutory audit (Baker Tilly UK Audit LLP)	**43**	59
Reporting accountant services (Baker Tilly Corporate Finance LLP)	**—**	167
Taxation services (Baker Tilly Tax and Accounting Limited)	**19**	15
Non-statutory audit services (Baker Tilly UK Audit LLP)	**3**	6
	65	247

3 PARTICULARS OF EMPLOYEES

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

	2012 Number	2011 Number
Number of administrative staff	**5**	5
Number of operational staff	**54**	34
Number of sales staff	**3**	—
Number of IT staff	**3**	—
Number of Directors	**3**	3
	68	42

3 PARTICULARS OF EMPLOYEES CONTINUED

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

	2012 £'000	2011 £'000
Wages and salaries	**2,170**	1,711
Social security costs	**256**	195
Staff pension costs	**40**	40
Director pension costs	**18**	19
	2,484	1,965

4 DIRECTORS' EMOLUMENTS

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

	2012 £'000	2011 £'000
Emoluments receivable	**518**	586
Fees	**50**	333
Value of Group pension contributions to money purchase schemes	**4**	3
Other pension	**14**	16
	586	938

Emoluments of highest paid Director	2012 £'000	2011 £'000
Total emoluments	**350**	310
Pension contributions	**13**	10

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

	2012 Number	2011 Number
Money purchase schemes	**1**	2

5 FINANCE COSTS AND FINANCE INCOME

	2012 £'000	2011 £'000
Finance costs		
Bank loans and overdrafts	**738**	533
Finance leases	**1**	2
Total finance costs	**739**	535
Finance income		
Bank interest receivable	**33**	41

Notes to the financial statements continued

For the year ended 31 December 2012

6 TAXATION

	2012 £'000	2011 £'000
Analysis of charge in the year		
Current tax:		
Current income tax expense	**200**	212
Over provision in prior year	**77**	—
Total current income tax	**277**	212
Deferred tax:		
Origination and reversal of temporary differences	**637**	909
Tax on profit on ordinary activities	**914**	1,121

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

	2012 £'000	2011 £'000
Profit before tax	**5,227**	3,311
Tax at the UK corporation tax rate of 24.5% (2011: 26.5%)	**1,281**	877
Expenses not deductible for tax purposes	**45**	228
Adjustments to tax charge in respect of previous periods	**(174)**	51
Change in tax rate	**(221)**	(35)
R&D enhanced deductions	**(17)**	—
Tax expense in the income statement	**914**	1,121

7 EARNINGS PER SHARE

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

	2012 £'000	2011 £'000
Profit for the year used for calculation of basic EPS	**4,313**	2,190
Amortisation of intangible assets	**238**	235
Exceptional costs	**1,243**	677
Tax effect of adjustments	**(355)**	(92)
Earnings for the purpose of adjusted EPS	**5,439**	3,010

Number of shares	2012	2011
Weighted average number of ordinary shares for the purposes of basic EPS	**83,339,747**	74,709,610
Effect of potentially dilutive ordinary shares:		
– share options	**2,957,911**	728,577
Weighted average number of ordinary shares for the purposes of diluted EPS	**86,297,658**	75,438,187
Earnings per share:		
– basic (pence)	**5.18**	2.93
– diluted (pence)	**5.00**	2.90
Adjusted earnings per share:		
– basic (pence)	**6.53**	4.03
– diluted (pence)	**6.30**	3.99

The Directors consider that the adjusted earnings per share calculation gives a better understanding of the Group's earnings per share.

8 DIVIDENDS

	2012 £'000	2011 £'000
Equity dividends		
Paid during the year:		
Dividends on equity shares £0.005 (2011: £600)	**417**	180
Total dividends	**417**	180

9 INTANGIBLE ASSETS

	Research and development £'000	Software £'000	Total £'000
Cost			
As at 1 January 2011	171	1,810	1,981
Additions	388	—	388
As at 31 December 2011	559	1,810	2,369
Additions	269	—	269
As at 31 December 2012	**828**	**1,810**	**2,638**
Amortisation			
As at 1 January 2011	14	235	249
Charge for year	—	235	235
As at 31 December 2011	14	470	484
Charge for year	3	235	238
As at 31 December 2012	**17**	**705**	**722**
Net book value			
At 31 December 2012	**811**	**1,105**	**1,916**
At 31 December 2011	545	1,340	1,885
At 1 January 2011	157	1,574	1,731

Notes to the financial statements continued

For the year ended 31 December 2012

10 PROPERTY, PLANT AND EQUIPMENT

	Short leasehold property £'000	Plant and machinery £'000	Fixtures and fittings £'000	Equipment £'000	Total £'000
Cost					
As at 1 January 2011	31	13,852	24	133	14,040
Additions	—	9,168	1	163	9,332
As at 31 December 2011	31	23,020	25	296	23,372
Additions	72	16,200	91	17	16,380
Disposals	—	—	(13)	—	(13)
As at 31 December 2012	**103**	**39,220**	**103**	**313**	**39,739**
Depreciation					
As at 1 January 2011	12	977	4	96	1,089
Charge for year	6	918	5	27	956
As at 31 December 2011	18	1,895	9	123	2,045
Charge for year	12	1,534	11	42	1,599
Disposals	—	—	(9)	—	(9)
As at 31 December 2012	**30**	**3,429**	**11**	**165**	**3,635**
Net book value					
At 31 December 2012	**73**	**35,791**	**92**	**148**	**36,104**
At 31 December 2011	13	21,125	16	173	21,327
At 1 January 2011	19	12,875	20	37	12,951

HIRE PURCHASE AGREEMENTS

Included within the net book value of £36,104,000 (2011: £21,327,000, 2010: £12,951,000) is £115,000 (2011: £145,000, 2010: £Nil) 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 £31,000 (2011: £8,000, 2010: £23,000).

The assets are secured by a bond and floating charge (note 16).

11 FINANCIAL ASSET INVESTMENTS

SUBSIDIARY UNDERTAKINGS

	Country of incorporation	Holding	Proportion of shares held	Nature of business
All held by the Company:				
UK Gas Connection Limited	Scotland	Ordinary shares	100%	Gas utility management
UK Meter Assets Limited	Scotland	Ordinary shares	100%	Gas utility management
UK Data Management Limited	Scotland	Ordinary shares	100%	Data management
UKMA (AF) Limited*	England	Ordinary shares	100%	Leasing

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

12 INVENTORIES

	2012 £'000	2011 £'000
Inventories	**373**	83

13 TRADE AND OTHER RECEIVABLES

	2012 £'000	2011 £'000
Trade receivables	**1,270**	480
Prepayments	**60**	24
Accrued income	**1,516**	965
Other receivables	**32**	63
VAT recoverable	**213**	74
Other debtors	**—**	—
	3,091	1,606

The debtors above include the following amounts falling due after more than one year:

	2012 £'000	2011 £'000
Other receivables	**—**	34

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. The amounts presented in the statement of financial position are net of allowances for doubtful receivables. There was no allowance for doubtful receivables in the year (2011: £Nil, 2010: £Nil). The ageing profile of trade receivables past due date is shown below:

	2012 £'000	2011 £'000
31–60 days	**148**	20
60–90 days	**56**	15
Over 90 days	**49**	10
	253	45
Allowance for doubtful receivables	**—**	—
	253	45

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

Trade receivables due from related parties at 31 December 2012 amounted to £Nil (2011: £34,000, 2010: £31,000).

Receivables are all in Sterling denominations.

The Directors are of the opinion that none of the overdue debts as at 31 December 2012 (2011: £Nil, 2010: £Nil) require impairment.

14 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash held by the Group. The carrying amount of the asset approximates the fair value. All balances are held in Sterling.

During each period, there were no amounts of cash placed on short-term deposit.

For the purposes of the cash flow statement, cash and cash equivalents comprise:

	2012 £'000	2011 £'000
Cash	**6,455**	7,317
Bank overdraft	**—**	—
	6,455	7,317

Notes to the financial statements continued

For the year ended 31 December 2012

15 TRADE AND OTHER PAYABLES

	2012 £'000	2011 £'000
Current		
Trade payables	**3,434**	2,035
Other payables	**12**	10
Other taxes	**176**	143
Corporation tax	**148**	161
Deferred income	**88**	—
Accruals	**4,343**	4,030
	8,201	6,379

The maturity profile of trade payables is given below:

	2012 £'000	2011 £'000
Current	**2,518**	1,530
31–60 days	**607**	281
60–90 days	**42**	39
Over 90 days	**266**	185
	3,433	2,035

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

All trade liabilities are Sterling denominated.

16 BANK LOANS AND OVERDRAFTS

	2012 £'000	2011 £'000
Current		
Bank loans	**2,150**	1,328
Bank overdraft	**—**	—
	2,150	1,328
Non-current		
Bank loans	**18,299**	9,845
Bank overdraft	**—**	—
	18,299	9,845

Bank loans at 31 December 2012 relate to a new term loan facility of £45.0m that was finalised in August 2012.

The term loan is available for 24 months, is payable in equal quarterly instalments based on a ten year repayment profile, with a final repayment date of 31 July 2017. The term loan attracts interest at a rate of 2.9% over the three month LIBOR. 1.45% is paid on undrawn funds.

The banks have a bond and floating charge over current and future property and assets.

The Group have fixed the bank interest payable through an interest rate swap (see note 18).

17 COMMITMENTS UNDER HIRE PURCHASE AGREEMENTS

Future minimal commitments under hire purchase agreements are as follows:

	2012 £'000	2011 £'000
Current		
Amounts payable within one year	**3**	3
Non-current		
Amounts payable between two to five years	**10**	13
Amounts payable after more than five years	**—**	—
	10	13

The Group has hire purchase contracts for various items of computer equipment. These leases have terms of renewal but no purchase options and escalation clauses. Renewals are at the option of the specific entity that holds the lease.

The Directors consider that the future minimum lease payments under hire purchase contracts approximate to the present value of the minimum payments. Obligations under hire purchase contracts are secured on the underlying assets.

18 OTHER FINANCIAL LIABILITIES AND ASSETS

The Group's treasury policy and management of financial instruments, which form part of these financial statements, are set out in the Financial Review.

	2012 £'000	2011 £'000
Other financial assets	**—**	18
Non-current liabilities		
Other financial liabilities	**170**	339

Other financial assets and liabilities relate to the fair value adjustment on interest rate swaps.

The Group uses interest rate swaps to manage interest rate risk on interest-bearing loans and borrowings which means that the Group pays a fixed interest rate rather than being subject to fluctuations in the variable rate. The Group has not designated these derivatives as cash flow hedges.

The interest rate swaps cover an interest rate swap for an amount of £13,200,000 as at 31 December 2012 (2011: £5,500,000, 2010: £3,800,000) and an interest rate cap over an amount of £Nil as at 31 December 2012 (2011: £5,500,000, 2010: £4,000,000).

The interest rate swap results in a fixed interest rate of 0.90–0.92%.

The termination date for the derivatives is 15 September 2016.

The movement in the fair value is shown below:

	2012 £'000	2011 £'000
Interest rate swap		
Opening position	**18**	99
Adjustment to fair value	**(18)**	(81)
Closing position	**—**	18
Interest rate cap		
Opening position	**(339)**	(171)
Adjustment to fair value	**169**	(168)
Closing position	**(170)**	(339)

Notes to the financial statements continued

For the year ended 31 December 2012

18 OTHER FINANCIAL LIABILITIES AND ASSETS CONTINUED

FAIR VALUES

The Directors do not consider there to be any material differences between the fair values and carrying values of any financial assets or liabilities recorded within these financial statements at the balance sheet date other than as set out below.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

— Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

— Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

— Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

At 31 December 2012, the Group held the following financial instruments measured at fair value:

Liabilities measured at fair value	31 December 2012 £'000	Level 1 £'000	Level 2 £'000	Level 3 £'000
Financial liabilities at fair value through the income statement:				
Interest rate derivatives	**170**	—	170	—

Fair value has been assessed on a Mark to Market basis.

The above liabilities are shown on the statement of financial position as other current financial assets and other current financial liabilities.

During the reporting period ended 31 December 2012, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements.

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:

Pound Sterling	Increase/decrease in basis points	Effect on profit before tax £'000
2012	**1%**	**65**
2011	1%	51

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
2012	**13,213**	**7,249**	**20,462**
2011	5,516	5,673	11,189
1 January 2011	5,000	4,434	9,434

The fixed rate financial liabilities relates to the portion of the banking facility that is fixed through hedging instruments.

19 FINANCIAL RISK MANAGEMENT CONTINUED

INTEREST RATE RISK PROFILE OF FINANCIAL LIABILITIES CONTINUED

The following is the maturity profile of the Group's financial liabilities as at 31 December:

	2012 £'000	2011 £'000
Fixed rate		
Less than one year	**1,324**	642
Two to five years	**5,289**	2,430
Over five years	**6,600**	2,444
	13,213	5,516
Variable rate		
Less than one year	**803**	630
Two to five years	**3,212**	2,521
Over five years	**3,234**	2,522
	7,249	5,673

INTEREST RATE RISK PROFILE OF FINANCIAL ASSETS

The Group's financial assets at 31 December 2012 comprise cash and trade receivables. The cash balance of £6,455,000 (2011: £7,317,000, 2010: £1,835,000) 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 rates is insignificant as primarily all of the Group's operating activities are denominated in pound Sterling.

LIQUIDITY RISK

The Group manages its cash in a manner designed to ensure maximum benefit is gained whilst ensuring security of investment sources. The Group's policy on investment of surplus funds is to place deposits at institutions with strong credit ratings.

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

CREDIT RISK

Credit risk with respect to trade receivables is due to the Group trading with a limited number of companies who 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 and other receivables.

The Group's maximum exposure to credit risk from its customers is £2,786,000 (2011: £1,445,000, 2010: £1,078,000) as disclosed in note 13 – trade and other receivables.

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 EBITDA. Net debt is calculated as total borrowings less cash. EBITDA is calculated as operating profit before any significant non-recurring items, interest, tax, depreciation and amortisation.

Notes to the financial statements continued

For the year ended 31 December 2012

20 DEFERRED TAXATION

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

	2012 £'000	2011 £'000
Opening deferred tax liability	**1,873**	964
Increase in provision through income statement	**637**	909
Closing deferred tax liability	**2,510**	1,873

All movements identified have gone through the income statement.

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

	2012 £'000	2011 £'000
Excess of taxation allowances over depreciation on fixed assets	**2,788**	2,329
Tax losses available	**(239)**	(371)
Fair value of interest rate swaps (net)	**(39)**	(85)
	2,510	1,873

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

	2012 £'000	2011 £'000
Accelerated capital allowances	**459**	924
Tax losses	**132**	50
Movement in fair value of interest rate swaps	**46**	(65)
	637	909

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 £41,500 (2011: £41,500, 2010: £65,500) to the Directors' pension scheme, Eco Retirement Benefit Scheme, for the use of certain premises. Both Stephen Timoney and Alan Foy are trustees of the scheme. At the year-end date, an amount of £4,150 (2011: £4,150, 2010: £6,414) was outstanding in this regard.

During the year, the Group paid dividends to Stephen Timoney and Alan Foy of £125,024 and £66,675 respectively.

Remuneration of key management which includes executive and non-executive directors together with certain management personnel:

	At 31 December 2012 £'000	At 31 December 2011 £'000
Salaries and other short term employee benefits	**754**	953

22 SHARE CAPITAL

	2012 £'000	2011 £'000
Allotted and called up: 83,339,747 ordinary shares of £0.01 each (2011 and 2010: 83,339,747 ordinary shares of £1 each)	**833**	833

On 17 June 2011 each of the 300 ordinary shares of £1 each then in issue was sub-divided into 100 ordinary shares of £0.01 each.

On 17 June 2011 4,980,000 ordinary shares of £0.01 each were issued to Steve Timoney and Alan Foy by means of a bonus issue.

On 20 June 2011 61,663,080 ordinary shares of £0.01 each were issued to Steve Timoney and Alan Foy by means of a bonus issue.

On 8 July 2011 16,666,667 ordinary shares were issued for £0.60.

23 SHARE-BASED PAYMENTS

On 20 June 2011 the Company adopted both an Approved Company Share Option Plan (the 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.

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.

Plan	At 1 January 2012	Granted	Lapsed	At 31 December 2012	Exercise price (pence)	Date exercisable	Expiry date
CSOP	578,952	—	(6,579)	572,373	76.0	15/7/14	15/7/21
CSOP	—	39,088	—	39,088	153.5	28/5/15	28/5/22
CSOP	—	12,097	—	12,097	248.0	3/12/15	3/12/22
Unapproved	3,082,333	—	—	3,083,333	60.0	20/6/16	20/6/21
Unapproved	717,500	—	—	717,500	60.0	20/6/12*	20/2/21
Unapproved	—	1,162,629	—	1,162,629	153.5	28/5/17	28/5/22
Unapproved	—	805,660	—	805,660	248.0	3/12/17	3/12/22

* Only 50% of the options can be exercised at this date.

VALUATION

The fair value of all options granted has been estimated using the Black-Scholes option model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model used for the year ended 31 December 2012:

	CSOP	Unapproved Plan
Dividend yield	1.25%	1.25%
Expected share price volatility	40%	40%
Risk-free interest rate	0.40%	0.77%
Expected life of option (years)	3	5
Option strike price (£)	2.48	2.48
Share price (£)	2.48	2.48

The weighted average fair value of share options issued during the year was £1.82.

24 OTHER RESERVE

This is a non-distributable reserve that arose by applying merger relief under s162 CA06 to the shares issued in 2008 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".

25 COMMITMENTS UNDER OPERATING LEASES

The Group has entered into commercial leases for office space. These leases have lives between one and 15 years with no renewal option 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:

	2012 £'000	2011 £'000
Future minimal commitments under operating lease agreements are as follows:		
Payable within one year	**65**	68
Payable within two and five years	**704**	166
Payable after five years	**176**	218
	945	452

26 ULTIMATE CONTROLLING PARTY

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

27 CONTINGENT LIABILITY

The Group is the subject of an ongoing HMRC enquiry in respect of payments made to Employee Benefit Trusts in prior years. Whilst the outcome of the enquiry is, as yet, uncertain, the beneficiaries of the Trusts have provided the Company with indemnities against any additional tax that may become payable as a result of these enquiries.

Parent company balance sheet

As at 31 December 2012

	Notes	2012 £'000	2011 £'000
Fixed assets			
Investments	2	—	—
Current assets			
Debtors	3	10,518	9,685
Creditors			
Amounts falling due within one year	4	5	5
Net current assets		10,513	9,680
Total assets less current liabilities		10,513	9,680
Capital and reserves			
Called up share capital	6	833	833
Share premium	7	8,653	8,653
Profit and loss account	7	1,027	194
Equity shareholders' funds		10,513	9,680

The parent company financial statements on pages 42 to 44 were approved and authorised for issue by the Board of Directors and signed on their behalf by:

Glen Murray
Director
20 March 2013

Company Registration Number
SC367563

Notes to the parent company financial statements

For the year ended 31 December 2012

1 PARENT COMPANY ACCOUNTING POLICIES

BASIS OF ACCOUNTING

The parent company financial statements have been prepared under the historical cost convention, with the exception of current asset investments held at valuation, and in accordance with applicable accounting standards.

No separate income statement is provided for Smart Metering Systems plc as permitted by S409(3) of the Companies Act 2006.

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.

TURNOVER

Turnover represents revenue recognised in the accounts. Revenue is recognised when the Company fulfils its contractual obligations to customers by supplying goods and services, or when they have the right to receive the income, and excludes value added tax. Where turnover is recognised due to the right to receive the income and the Company has not invoiced for the goods or services supplied an accrual is incorporated for the estimate of providing such.

DEFERRED TAXATION

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the consolidated financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the consolidated financial statements.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

FINANCIAL INSTRUMENTS

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the entity after deducting all of its financial liabilities.

Where the contractual obligations of financial instruments (including share capital) are equivalent to a similar debt instrument, those financial instruments are classed as financial liabilities. Financial liabilities are presented as such in the balance sheet. Finance costs and gains or losses relating to financial liabilities are included in the profit and loss account. Finance costs are calculated so as to produce a constant rate of return on the outstanding liability.

Where the contractual terms of share capital do not have any terms meeting the definition of a financial liability then this is classed as an equity instrument. Dividends and distributions relating to equity instruments are debited direct to equity.

2 INVESTMENTS

Company	Group companies £'000
Cost	
At 1 January 2012	—
Additions	—
At 31 December 2012	—
Net book value	
At 31 December 2012	—
At 31 December 2011	—

SUBSIDIARY UNDERTAKINGS

	Country of incorporation	Holding	Proportion of shares held	Nature of business
All held by the Company:				
UK Gas Connection Limited	Scotland	Ordinary shares	100%	Gas utility management
UK Meter Assets Limited	Scotland	Ordinary shares	100%	Gas utility management
UK Data Management Limited	Scotland	Ordinary shares	100%	Data management
UKMA (AF) Limited*	England	Ordinary shares	100%	Leasing

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

Notes to the parent company financial statements

For the year ended 31 December 2012

3 DEBTORS AMOUNTS FALLING DUE WITHIN ONE YEAR

	2012 £'000	2011 £'000
Amounts owed by Group undertakings	**10,518**	9,685
	10,518	9,685

4 CREDITORS AMOUNTS FALLING DUE WITHIN ONE YEAR

	2012 £'000	2011 £'000
Other creditors	**5**	5
	5	5

5 RELATED PARTY TRANSACTIONS

The Company had no material related party transactions to disclose in line with Financial Reporting Standard 8.

The Group has taken advantage of the exemption in Financial Reporting Standard 8 from the requirement to disclose transactions within the Group.

6 SHARE CAPITAL

	2012 £'000	2011 £'000
Allotted and called up:		
83,339,747 ordinary shares of £0.01 each (2011: 83,339,747 ordinary shares of £0.01 each)	**833**	833

7 RESERVES

	Profit and loss reserve £'000	Share premium £'000	Share capital £'000
As at 1 January 2012	194	8,653	833
Returned earnings	1,250	—	—
Dividend paid	(417)	—	—
As at 31 December 2012	**1,027**	**8,653**	**833**

8 CONTINGENT LIABILITY

The Group is the subject of an ongoing HMRC enquiry in respect of payments made to Employee Benefit Trusts in prior years. Whilst the outcome of the enquiry is, as yet, uncertain, the beneficiaries of the Trusts have provided the Company with indemnities against any additional tax that may become payable as a result of these enquiries.

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