August 2018

Mitie Group plc

IFRS 15 Teach-in

Agenda

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Introduction

What is the new standard?

Background

- IFRS 15 *Revenue from contracts with customers* is the new standard for contract accounting and will determine how we recognise revenues and costs on all of our contracts going forward.
- Adoption is mandatory for all accounting periods commencing on or after 1st January 2018 – we decided to early adopt for the financial year ended 31st March 2018.

Purpose and objectives of this "Teach-in"

- ✓ Provide an understanding of the key requirements of the standard.
- ✓ Summarise our process applied to adoption.
- ✓ Consider how the adoption of the standard impacted Mitie.
- ✓ Summarise the full year results under IFRS 15.
- ✓ Outline the projections for 2019 and beyond.

Why early adopt – continued balance sheet simplification

- The standard is in line with our strategy to simplify and de-risk the balance sheet.
- Early adoption was supported and encouraged by our external auditor, BDO. Achieving early adoption of IFRS 15 was a key point in their audit tender.
- We highlighted our intention to early adopt to investors, and this approach was welcomed as it represents a significant improvement in the Group's accounting and disclosure.
- Implementing the new standard provides an opportunity for a thorough review of accounting practices to ensure that we have consistency of application across the Group.
- IFRS 15 provides a much closer link between actual contract performance and the accounting for the associated revenue, and so greatly increases the transparency of our reporting.

Adoption option – pragmatic methodology chosen

There are two transition options available under IFRS 15:

- **Fully retrospective method**

  Applied at the start of the reporting period (1st April 2016) with prior year comparatives restated; or

- **Cumulative retrospective method**

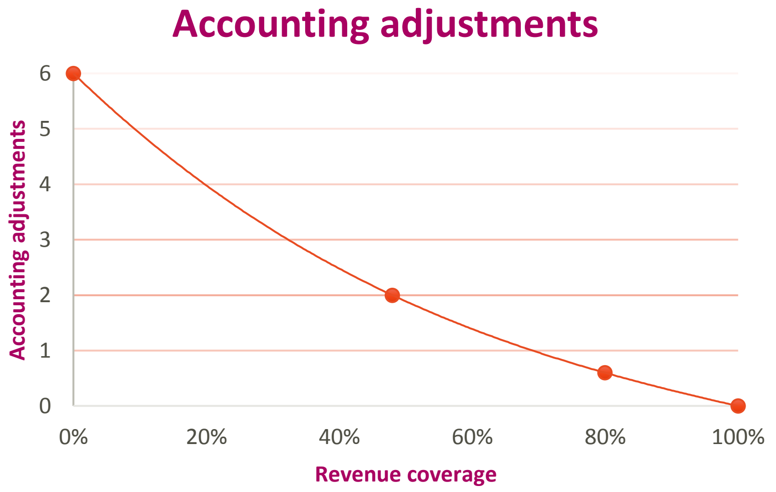
  Applied at 1st April 2017 with a note to the accounts to show the accounting under the previous standards for the year ended 31st March 2018. No prior year restatement of the comparatives.

What approach did we take and why?

- The cumulative retrospective method of transition was selected with the impact of adoption applied at 1st April 2017. The result being no prior year restatement and a note to the accounts to show the accounting under IAS 11 and IAS 18 for the year to 31st March 2018.
- We applied IFRS 15 to open contracts earning revenue at the application date using the practical expedient election available under IFRS 15.
- Fully retrospective would have been significantly more time consuming and expensive due to the changes the Group has undergone in recent years.
- Cumulative retrospective, while more efficient and cost effective, does mean that we are unable to provide historical IFRS 15 adjustments for the Group.

Process followed was structured and externally supported

- Our adoption project was supported by a specialist team from EY who had extensive experience of similar projects in our industry.
- Due to the volume and diversity of our contracts a tiered approach was taken to the analysis of the impact of IFRS 15:
- Our advisor facilitated contract review workshops with Divisional teams, transferring key accounting knowledge in the process.
- Our work on larger contracts proved that the smaller the contract, the less likely the need for IFRS 15 adjustments. A final top down review confirmed a small number of adjustments in the final 20% of contracts.
- A detailed contract review questionnaire was developed in order to consistently capture the key contract criteria and accounting impacts.



Five step approach followed

Core principle

"Recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."

Step 1	**Identify the contract(s) with the customer**
Step 2	**Identify the separate performance obligations in the contract**
Step 3	**Determine the transaction price**
Step 4	**Allocate the transaction price to the performance obligations**
Step 5	**Recognise revenue when (or as) each performance obligation is satisfied**

For Mitie this means:

- It will be necessary to reassess contracts with our customers using this five-step model, in order to understand the impact of the standard.
- Systems and associated business processes are likely to require changes in order to implement the standard.

Step 2 is the most important and subjective due to the complex and integrated nature of service contracts.

A typical integrated FM contract will be multi-year, include a number of service lines, and will have fixed fee, variable work, and project works. As a result the identification of individual performance obligations against which to recognise revenue is a complex exercise requiring the application of judgement.

Robust governance in place

- A robust structured process was followed to ensure the completeness and accuracy of the adjustments made.

Oversight by IFRS 15 steering committee and Mitie Audit Committee

1. Consistent process developed based upon a detailed contract review questionnaire
2. Training for all Mitie staff involved in the IFRS 15 project
3. 50% of contract questionnaires independently reviewed by EY / IFRS 15 team / Internal Audit
4. Advisor led meetings to address any unusual issues identified
5. BDO audit of FY18 results and disclosures

Dedicated IFRS 15 Project Team

Impacts for Mitie

Clarity on revenue recognition

The main differences between the existing accounting standards and IFRS 15 are:

Factors impacted by accounting policy treatment	Permitted by: IAS 11 and IAS 18	Permitted by: IFRS 15
Percentage of completion accounting / revenue matched to the costs incurred	✓	✗
Capitalisation of all direct mobilisation costs after preferred bidder status	✓	✗
WIP recognised on the balance sheet	✓	✗
Creation of contract fulfilment assets meeting the new Group accounting policy	**n/a**	✓
Deferment of design and development and other upfront fees linked to contract outcomes	✗	✓

The typical Mitie contract

Long term customer relationship, with a large proportion of the service fixed for the contract term

Revenue from variable works and project works in addition to the fixed fee services

Significant up front investment to set-up and transform service delivery model

Investment will often be funded in part by the customer

Reduction in delivery costs and therefore improving margins as the service transformation is delivered

Significant change in accounting approach

IAS 18/11	IFRS 15
PoC accounting is applied to smooth revenue & margin over the contract term	PoC revenue smoothing is not permitted
Revenue is recognised in proportion to costs incurred	Revenue is recognised as the obligations under the contract are delivered
Work-in-progress is held on the balance sheet as accrued income	Costs associated with work-in-progress are written off as incurred
Assets are recognised representing the cost of the initial investment; these are amortised over the contract term	More restrictive rules regarding the recognition of investment assets
Client funding of upfront investment is recognised as revenue when the investment occurs	Client funding of upfront investment, where this is not a separate performance obligation, is deferred an recognised as the obligations under the contract are delivered

Case Study for Mitie

Case Study – Our business model

mitie

Transformational contracts

We take an existing process run by a customer and aim to transform this into a more efficient and integrated service which adds value to the client as the contract progresses.

A target operating model is generated which determines the lifetime margin and profitability of the contract – it factors in cost savings as processes become more efficient; and contracted discounts over the term, as expected costs decrease.

We seek to ensure the initial costs required to mobilise or transform a contract are matched by up-front payments from the customer.

The outcome we seek to achieve is to meet client expectations for the service output we provide. Customers are focused on the effective delivery of contract outcomes rather than the inputs into how we achieve them.

The adoption of IFRS 15 brings with it an alignment of contract outcomes with accounting principles where cash receipts are more closely aligned with the work delivered and therefore revenue recognised from our customers.

Case Study – The scenario

Integrated FM contract

Parties:

Mitie Limited

Large and complex plc

A 10 year transformational contract.

The contract has a forward order book of £500m.

Transformation of the customers existing services (mobilisation) is expected to cost £10m.

The client will pay £5m to part fund the cost of mobilisation (a Design & Development fee)

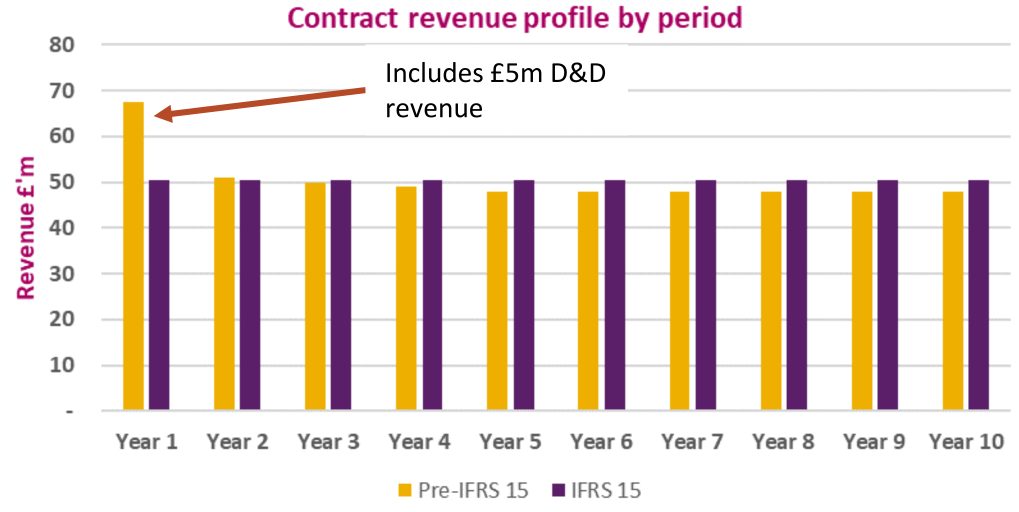
The contract has a single performance obligation (i.e. no separate obligation for transformation)

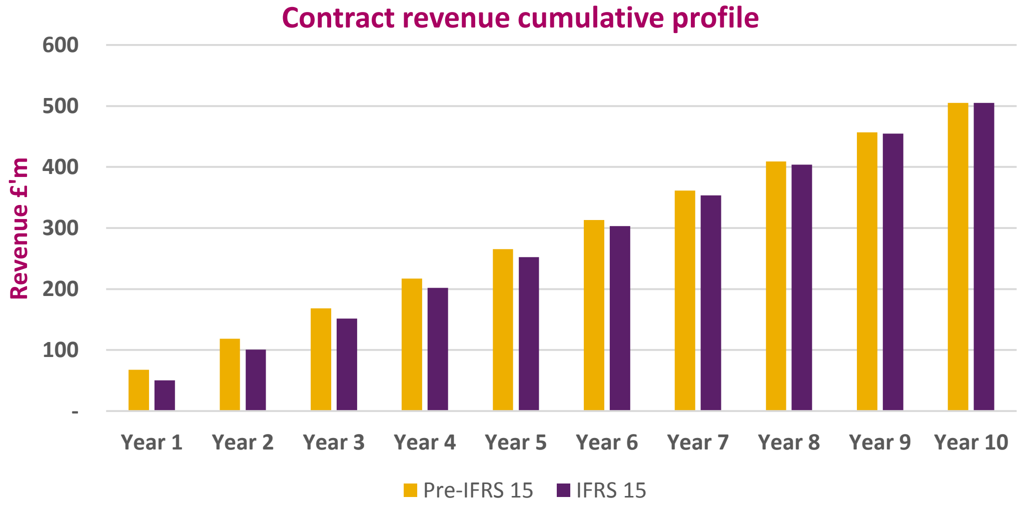
The overall lifetime margin is forecast at 5%. Mitie expect to achieve this overall margin by reducing the current delivery cost by 2% pa cumulative in each of contract years 2 to 5.

What are the main IFRS 15 impacts?

Case Study – Revenue impact

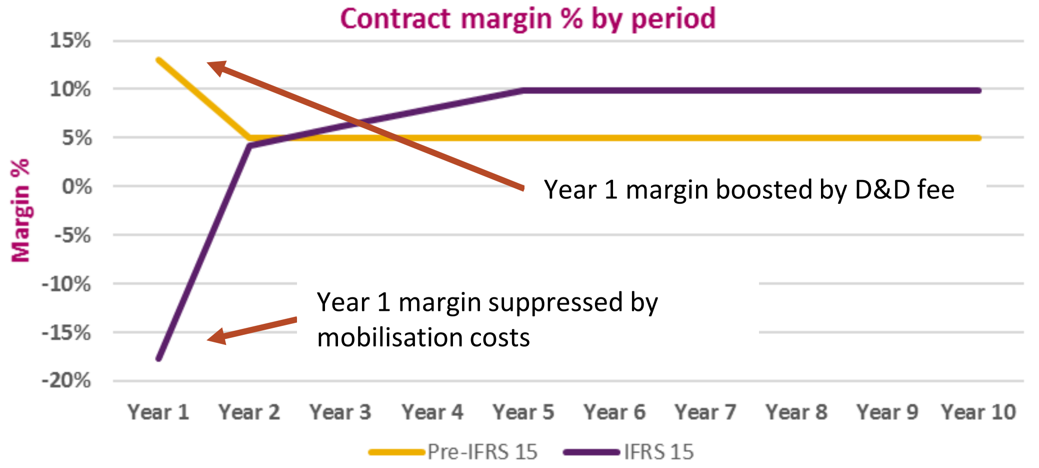
- ✓ Revenue is no longer recognised in proportion to the costs incurred – an input basis.
- ✓ Instead revenue is recognised in relation to the services delivered (performance obligations delivered) – an output basis.
- ✓ As result the revenue is recognised on a straight-line basis over the contract term.
- ✓ Straight-line revenue recognition includes D&D fees which were previous recognised as revenue upon completion of the contract mobilisation
- ✓ Cash received is unchanged but there is increased deferred income which unwinds over the contract term because cumulative customer cash receipts are more than the cumulative revenue recognised.
- ✓ There is no impact on the whole life contract revenue.

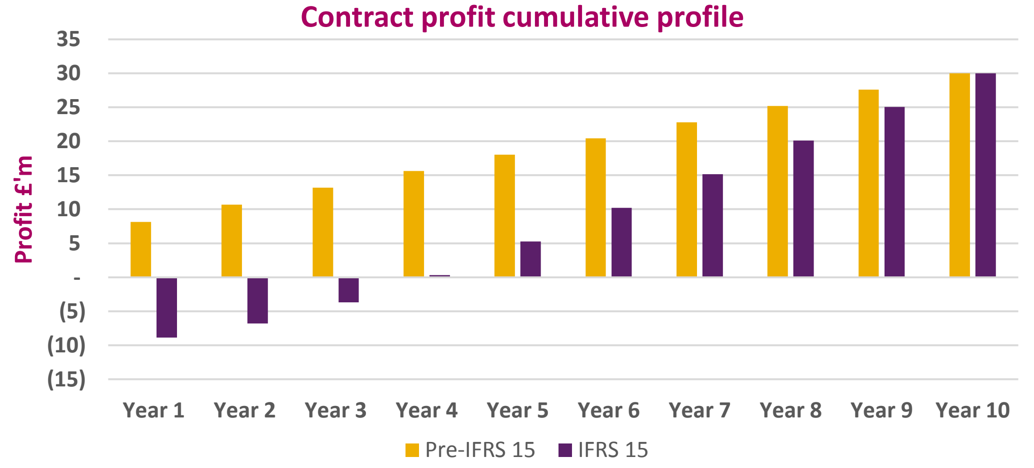




Case Study – Profit and margin impact

- ✓ Costs continue to be recognized and expensed to the income statement as they are incurred.
- ✓ As noted previously revenue recognition follows delivery of the performance obligations under the contract – an output basis.
- ✓ Under this case study, mobilisation of the contract is not considered to be a performance obligation under IFRS 15 and consequently does not drive recognition of any revenue.
- ✓ Similarly the profile of Mitie's costs to deliver the services has no influence upon the recognition of revenue.
- ✓ As a result the contract is loss-making in early years, with the margin improvement being reflected in the outer years as the cost savings are achieved.





Summary of financial impact

Summary financial impact – FY18 results

Impact summary £m	FY 17/18 Reported	FY 17/18 Pre IFRS 15	Difference
Revenue	**2,203.7**	2,199.1	4.6
Operating profit before other items	**89.6**	77.1	12.5
Net cash movement in year	**(46.3)**	(46.3)	-
Net debt	**193.5**	193.5	-
Net (liabilities)/assets	**(24.0)**	69.8	(93.8)

IFRS 15 balance sheet adjustments £m	FY 17/18
POC accounting	(37.5)
Mobilisation assets	(20.5)
Design and development	(26.8)
Contract assets	1.0
Work in progress	(31.1)
Contracted discounts	(0.7)
Total IFRS 15 adjustments - pre-tax	**(115.6)**
Corporation tax	21.8
Total IFRS 15 adjustments - post-tax	**(93.8)**
Net assets pre IFRS 15	69.8
Total IFRS 15 adjustments	(93.8)
Net liabilities - reported	**(24.0)**

How have the FY18 results been impacted by IFRS 15?

- Revenue increased by £4.6m (0.2% of Revenue)
- Operating profit before other items increased by £12.5m (16.2% of operating profit)
- Loss before tax decreased to £26.0m from £40.4m
- Net assets moved to net liabilities due to asset write off on application
- **No impact on Operating cash flow and net debt**

Summary financial impact in FY19

IFRS 15 (pre-tax) £m	Opening net asset adj	Operating Profit pre other items 2018	Operating Profit pre other items 2019
POC accounting	(50.2)	7.6	8.1
Mobilisation asset	(24.9)	4.4	4.0
Work in progress	(26.5)	(4.6)	-
Design and development and other items	(30.1)	3.3	4.9
Contract assets	-	1.0	(0.2)
Contracted discounts including extension discounts	(1.5)	0.8	0.7
Total	**(133.2)**	**12.5**	**17.5**
Impact of new contracts			
Mobilisation and similar fees			(5.0)
Design and development and other items			(3.0)
Total			**(8.0)**
Operating profit impact (illustration)			**9.5**

At the transition date 1 April 2017

Next steps

Statutory accounts	All IFRS 15 adjustments are required to be reflected in the legal entity's accounts, not just in the consolidated Group accounts.
Covenants	Until agreement is reached for a suitable adjustment, the banks require "frozen GAAP" accounting so there will be a requirement for dual reporting under the previous standards (IAS 11 and IAS 18) and IFRS 15.
Commercial	Understanding of the accounting impact will drive the way we contract commercially.
Systems	Requires an overlay of accounting adjustments to our existing accounts so we can produce frozen GAAP accounts. We will embed IFRS 15 into our financial systems to make automation possible dependant on the timing of any change in covenant requirements.
Restatement of half-year financial statements	Adoption of IFRS 15 will require restatement of the comparatives for HY18.
Other new standards	Mitie has adopted IFRS 9 *Financial Instruments* for the year ended 31st March 2019. This standard will require changes to a number of accounting processes, but is not expected to have a material impact upon the reported results. Mitie will be required to adopt IFRS 16 *Leases* no later than the year ended 31st March 2020. The primary impact of this will be to bring the Group operating leases on balance sheet through the recognition of a lease liability and a corresponding non-current asset.

Thank-you