

Business and operating review

At the start of the financial year we completed the re-alignment of the Group's operations into three areas consistent with both the markets we serve and how the business is managed:

- Integration & Managed Services (I&MS) for corporate and public sector organisations, delivered by Affiniti, Smart421 and JAM IP
- Telecoms & Internet Services (T&I) primarily for medium and small businesses delivered by Kingston Communications and Eclipse
- Information Services

The individual business segments have very distinct financial profiles. We are reporting in line with these business segments for the first time:

- Our T&I and Information Services segments benefit from having established business models based on leading regional market positions, together with growth potential through extending into adjacent markets. These parts of the Group produce good margins and significant operating cash flows and are well positioned to take advantage of growth opportunities in areas such as internet hosting services
- Our I&MS segment is less capital intensive and on a standalone basis is able to support the relatively low levels of capital investment

it requires to grow. This part of our business is in a period of significant transition as it moves away from commoditising enterprise and carrier network services and focuses on the delivery of higher quality revenues from consulting, professional and managed services.

This change is a continuing process which the Board believes will deliver improving returns over the medium to long term as we build both on the depth of skills we have assembled and on the quality of our customer relationships

The acquisitions of Smart421, JAM IP and Mistral Internet, made in the second half of the prior year, are playing an important part in the execution of our strategy. During the first half of this year we have worked to ensure they are positioned within the business in a way that maximises their benefit to the Group.

The performance of the T&I segment of the Group has been strong, reflecting the continued strength of our East Yorkshire business, organic growth from broadband and the impact of the acquisition of Mistral Internet.

The I&MS segment has performed in line with our expectations. Our first half focus in this area of the business has been on establishing a sound platform for improved operating performance in the medium term.

Across the Group we have made significant operating progress during the first half, with a number of projects being completed that will deliver future efficiencies. These include progress to integrate systems that will improve the efficiency with which we manage our large enterprise and public sector customers, investments in our inbound and outbound contact infrastructure that will lead to future productivity gains and the rationalisation of finance systems. We have implemented changes to the senior management team that will lead to a flatter structure leading in to 2008. This will see our senior leadership team reduce from 13 to nine executives by April next year.

Board changes

Paul Renucci, who joined the Group in April 2007 as Managing Director of Affiniti, our national communications integration business, joined the Board of KCOM on 26 November 2007 with responsibility for Affiniti. Paul (44) has 20 years of industry experience including roles at Damovo UK as Managing Director and as President of Nortel's Enterprise division in EMEA. Peter Halls, the current Executive Director for Affiniti, will step down from the Board on 20 December 2007.

Graham Holden, currently Chief Executive of Marshalls plc, was appointed to the Board as a Non-Executive Director on 26 November 2007. Formerly Finance Director of Marshalls,

he will replace Sean Christie who retired from the Board on 26 November 2007, after almost nine years as a Non-Executive Director and will chair the Audit Committee. We confirm there are no details requiring notification in accordance with s.9.6.13 (2) to (6).

Following the retirement of John Bailey, Company Secretary, Paul Simpson, Chief Financial Officer, will assume responsibility for company secretariat with immediate effect.

Financial overview

Group revenue for the half year has increased 8.0 per cent year on year to £261.3 million (2006: £241.9 million) and Group EBITDA, before exceptional items, has increased by 6.1 per cent to £35.9 million (2006: £33.7 million). The drivers of growth were the acquisitions made in the second half of the prior year and broadband growth within the T&IS element of the Group, offsetting lower revenue and EBITDA within the I&MS segment. Adjusted profit for the Group increased nearly 2 per cent to £19.4 million (2006: £19.1 million), reflecting overall growth in EBITDA offset by higher depreciation and amortisation charges on higher levels of investment in short life assets.

Group profit before tax decreased to £5.3 million from £10.3 million as a result of an increase in both interest and the amortisation of

intangible assets relating to acquisitions. This has resulted in a decrease in reported basic earnings per share to 1.41 pence per share (2006: 2.17 pence). Adjusted basic earnings per share of the Group are 2.52 pence (2006: 2.76 pence).

The interim dividend will increase by 44.6 per cent to 0.94 pence per share (2006: 0.65 pence per share).

Telecoms & Internet Services

Results before exceptional items:

	2007 (£m)	2006 (£m)	Change over prior year (%)
Revenue	122.3	110.0	11.2
Operating margin ¹	70.9	65.4	8.4
EBITDA	30.8	27.1	13.7

¹ Operating margin represents gross margin before the deduction of depreciation and amortisation and excludes gross overheads and general and administration expenses

The Group's T&IS operation comprises the Kingston Communications East Yorkshire business together with our UK wide regional small and medium enterprise ("SME") business, partner channel and Eclipse Internet. Results for the first half include a six month contribution from the Mistral Internet acquisition. The Mistral brand is now being phased out as we complete the integration of Mistral's hosting services into the service portfolio sold to SME businesses.

T&IS has delivered strong organic growth from most areas during the first half. Revenue increased 11.2 per cent from £110.0 million to £122.3 million, reflecting continued growth in the broadband base from 140,851 to 195,255. This growth in broadband numbers has more than offset the declining revenues from wholesale voice services, retail dial-up services and legacy premium rate services. Our broadband base now reflects 81,400 'on net' customers and 113,900 'off net', within which we are now delivering 45 per cent of our services through wholesale local loop unbundling. This has contributed to operating margin improvement. In addition we now have over 53 per cent of our total revenue within this segment subscription-based compared with 45 per cent in the prior year, providing us with increased future visibility of revenues.

EBITDA for this area of the business increased by 13.7 per cent to £30.8 million (2006: £27.1 million). This growth has been driven by strong broadband demand, operating efficiencies and Mistral, and has been achieved despite the ongoing and anticipated decline in legacy voice revenues.

Our approach to driving continued value in the T&IS segment will be to capitalise on our connected base within the SME sector by providing

hosting and related services, creating higher value relationships with existing customers. At the same time these combined capabilities will help drive new customer acquisition as we are able to offer a broader integrated access and hosted services package to SMEs.

At the same time we are continuing to achieve productivity gains in this area of the Group through the deployment of new IT and communications infrastructure throughout our own customer contact centres. Cost efficiencies are also being delivered through the ongoing transfer of national broadband customers to a wholesale unbundled local loop service. The outsourcing of the operation and management of our carrier network to Nortel will also drive longer term efficiencies.

The underlying resilience of the regional franchise in East Yorkshire combined with opportunities we are beginning to see for our combined access and hosting proposition into the SME market provide confidence that we can continue to deliver growth and consistent earnings and cash flow from this segment of the Group. Over the medium term we will continue to build on the efficiency gains we are starting to deliver from the investments made over the last six months.

Integration & Managed Services

Results before exceptional items:

	2007 (£m)	2006 (£m)	Change over prior year (%)
Revenue	139.9	134.5	4.0
Operating margin ²	27.3	27.0	1.11
EBITDA	4.6	6.9	(33.3)

² Operating margin represents growth margin before the deduction of depreciation and amortisation and excludes gross overheads and general and administration expenses

The I&MS sector of the Group comprises the following lines of business:

- Unified communications and managed network services delivered by Affiniti
- IP contact centre solutions delivered by JAM IP
- Storage and Data Management solutions delivered by DMS (Data Management Solutions)
- Applications integration and applications managed services delivered by Smart421

During the first half, we have established Affiniti as the partner of choice for our three specialist 'centres of excellence' (JAM IP, DMS and Smart421) in a way that ensures they can maximise growth opportunities that arise through exploiting the breadth of the Affiniti client base and at the same time capitalise on opportunities to work independently with customers and other partners.

The order profile experienced in the first half was broadly as anticipated. As reported in 2006, the first half last year benefited from a number of large enterprise network upgrade projects, particularly around the financial services market, that were both ordered and delivered in the same period last year.

We have seen some important new customer orders in the first half, including Phones4U and FFastfill, with Yorkshire Water and Marshalls being amongst the customers that have extended the scope of their contracts.

Overall, revenues increased 4.0 per cent to £139.9 million (2006: £134.5 million). Revenue growth has arisen as a result of the contributions made by the acquisition of Smart421 and JAM IP. Underlying revenues reduced by 3.0 per cent primarily as result of prior year revenues benefiting from some major network upgrade projects.

The EBITDA reduction to £4.6 million (2006: £6.9 million) reflects:

- The lower network upgrade project revenues in the first half of this year compared to the prior year reducing gross contribution by £1.7 million
- A £0.8 million year on year reduction in the value of one of our long-term managed services contracts consistent with the stage of the contract life cycle. As the contract has moved into the phase of providing ongoing services, the gross contribution reduced along with the level of capital expenditure incurred whilst building the customer's network
- The impact of implementing new 'in life' support arrangements for customers using Cisco technology has resulted in a £2.2 million increase in operating expenditure. As disclosed in 2006, this support model was introduced as it is more efficient from a cash perspective over the life cycle of a customer contract
- The balance of the year on year EBITDA improvement relates to a positive £2.4 million contribution from trading and acquisitions

During the second half the earnings performance for the I&MS segment is expected to be stronger than that of the first half based on:

- Higher order backlog of £194.8 million (2006: £183.6 million), an increase of 6.0 per cent year on year
- Benefits of the investment in the development of our sales resource
- Impact of operational improvements around our systems investment programmes

Over the course of the second half we will look to maintain tight operational control across all parts of this business area mindful of the uncertainty that does exist in the financial services market, an important vertical market for us. Outside of the financial services market, the applications integration services team have experienced lower demand for services from one key customer on the back of major restructuring of their business resulting in a material reduction in IT-related expenditure.

Our confidence for the longer term remains strong as we continue to improve the operational platform of the business, and seek to benefit from the new skills acquired in the second half of 2006/07. The business is increasingly capable of operating in higher growth segments of the market.

Our expectation is that the I&MS segment will report full year revenue in the range of £285-305 million with EBITDA and EBITA margins of between 3-5 per cent and 1-3 per cent respectively. We are targeting improved EBITA margins of 3-6 per cent in 2008/09 and 5-8 per cent in 2009/10. This reflects our revenue growth expectations of 5-10 per cent per annum and planned operational efficiencies in the medium-term.

Information Services

Results before exceptional items:

	2007 (£m)	2006 (£m)	Change over prior year (%)
Revenue	9.9	9.5	4.2
Operating margin ³	5.9	5.7	3.5
EBITDA	4.2	3.8	10.5

³ Operating margin represents growth margin before the deduction of depreciation and amortisation and excludes gross overheads and general and administration expenses

Our Information Services segment has performed well in the first half. Revenue increased by 4.2 per cent to £9.9 million (2006: £9.5 million) with EBITDA increasing by 10.5 per cent to £4.2 million (2006: £3.8 million).

These results reflect a strong sales campaign for Hull Colour Pages, continued success in the outsourced directory enquiries market and the expansion of an existing outsourced contact centre contract for the provision of outbound telesales capacity.

The launch of Information Services' local business directories, 'Know', throughout parts of Lincolnshire and Yorkshire has shown initial promise, with 10 directories launched in the first campaign. The second sales cycle has now started.

The resilience of our Hull Colour Pages brand, combined with the growth opportunity that Know offers and the consistent and accurate delivery of information to end users through our outsourced directory services proposition, leave the business well placed to deliver improving future performance.

Group earnings **EBITDA**

Group EBITDA before exceptional items has increased by 6.5 per cent to £35.9 million from £33.7 million. This increase has been driven by the acquisitions of Smart421, JAM IP and Mistral in the second half of last year. The increase in EBITDA delivered within the Information Services and T&IS segments has offset the decline reported within the I&MS segment.

Group EBITDA includes a loss on other activities of £3.7 million in the current year (2006: £4.3 million) and represents the unallocated corporate and operational costs.

The Group has incurred exceptional items of £1.2 million in 2007 (2006: £1.0 million) as a consequence of redundancy costs relating to restructuring.

Group EBITDA, after exceptional items, has increased by 6.3 per cent to £34.8 million from £32.7 million.

Depreciation and amortisation

Depreciation and amortisation amounted to £23.0 million in the current year (2006: £17.5 million). Included in this amount is £6.5 million in respect of the amortisation of intangible assets arising on acquisitions which has increased on the prior year amount of £2.9 million as a consequence of the inclusion of an amortisation charge in relation to the assets arising on the acquisitions of Smart421, JAM IP and Mistral in the prior period.

Depreciation of tangible fixed assets has increased from £11.0 million to £12.2 million, reflecting increased investment in T&IS in the last twelve month period.

Group profit from operations

Adjusted Group profit from operations, excluding the amortisation of intangible assets arising on acquisitions, has increased 1.6 per cent to £19.4 million (2006: £19.1 million) reflecting the increased EBITDA generated in the period.

Group profit from operations before exceptional items is £12.9 million (2006: £16.2 million), a decrease of 20.3 per cent reflecting a £3.6 million increase in the charge for the amortisation of intangible assets arising on acquisitions.

Finance costs

Group financing costs of £6.5 million (2006 £4.9 million) reflect a higher level of borrowings consistent with the financing in respect of the acquisitions completed in the prior year. In addition average LIBOR rates have been higher than in the prior year.

Profit before tax

Group profit before taxation has decreased 48.5 per cent to £5.3 million (2006: £10.3 million) reflecting the combined impact of increased depreciation, amortisation and interest costs.

Taxation

The taxation credit of £1.9 million (2006: £0.9 million) arises as a consequence of the taxation amortisation benefit associated with intangible assets arising on acquisitions.

Profit for the period from continuing operations

Profit for the period from continuing operations is £7.2 million (2006: £11.2 million).

Earnings per share

The Group reported an Adjusted profit for the period from continuing operations of £13.0 million (2006: £14.2 million) producing an Adjusted basic earnings per share of 2.52 pence (2006: 2.76 pence).

Basic earnings per share amounted to 1.41 pence (2006: 2.17 pence). Adjusted basic earnings per share amounted to 2.52 pence (2005: 2.76 pence).

Group financing and investment

Group net debt at 30 September 2007 was £173.2 million (2006: £150.8 million), reflecting the acquisitions made for cash during the second half of last year.

Net cash inflow from operations of £22.1 million has increased 7.3 per cent, (2006: £20.6 million). With movement in working capital being comparable year on year, this is due to an improvement in overall operating performance.

The purchase of tangible and intangible assets amounted to £19.5 million (2006: £14.7 million). The increase in this cash amount reflects a combination of high investment in the first half relative to the prior year plus the cash impact of high investment levels in the second half of last year.

The cash cost of dividends in 2007 was £6.7 million (2006: £4.0 million) reflecting the increased level of final dividend declared in the prior year financial results.

The cash cost of financing Group debt in the period amounted to £4.9 million (2006: £4.5 million). The increase in the profit and loss expense is greater as a consequence of the facility fee associated with the cash cost of refinancing being paid during the second half of the prior year.

In accordance with IAS 19, the Group now recognises the liabilities associated with its defined benefit pension scheme in the financial statements. As at 30 September 2007, the Group had a net liability in respect of its pension scheme obligations of £2.7 million (2006: £19.3 million). The triennial valuation of the Kingston Communications Defined Benefit Pension Scheme is currently being performed as at 1 April 2007, the results of which will be reflected in the results from the period to 31 March 2008.

During the period to 30 September 2007 the net retirement benefit liability has reduced from £12.7 million at 31 March 2007 to £2.7 million at 30 September 2007. The

principal reason for this reduction is the higher yield on corporate bonds which is used to discount the value of the scheme liabilities. Over the period the discount rate increased from 5.4 per cent at 31 March 2007 to 5.9 per cent at 30 September 2007.

Dividend policy

The Board has considered carefully the options to maximise value for shareholders and has concluded that in the near term it is preferable to align the distribution policy of the Company more closely to the performance of the T&IS and Information Services segments, being the more mature segments within the Group. This will have the effect of significantly improving the distribution of the Company's earnings. The Board expects to continue to pay dividends split in the ratio of one third/two thirds between the interim and final dividend.

As a result of implementing this approach, the Board will pay an interim dividend of 0.94 pence per share, representing an increase of 44.6 per cent on the prior year (2006: 0.65 pence per share), payable on 2 February 2008 to shareholders registered at the close of business on 21 December 2007.

Principal risks

The Group has identified key strategic, operational and financial risks. These risks, and principal actions to mitigate them, include:

- Pursuit and execution of appropriate strategies – managed by regular management and Board strategy performance reviews
- Retaining and recruiting the right staff – managed through the development of clear grading structures, reward strategies benchmarked against other businesses and targeted learning and development programmes
- Meeting customer expectations – managed by an appropriate customer-facing business structure, a commitment to certification and compliance with recognised standards (i.e. ISO 15000), the undertaking and analysis of regular customer feedback and a direct link in reward structures to achieving customer satisfaction

Outlook

The T&IS segment has increasing levels of recurring revenue and this, together with its growth prospects and strong margin profile, provides assurance of the future financial performance of this segment in the second half and beyond.

The I&MS segment currently has less forward visibility due to the mix of its revenues. However, the continued development of our capabilities and ongoing ability to secure new customers, combined with the fact that it is now cash generative, leaves us confident that our medium-term targets are achievable.

These factors are reflected in our increased interim dividend and demonstrate our confidence in the future growth of our business.

Forward-looking statements

Certain statements in this interim report are forward-looking. Although the Group believes that the expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these expectations will prove to have been correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements.

We undertake no obligation to update any forward-looking statements whether as result of new information, future events or otherwise.

Consolidated interim income statement

	Note	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Continuing Operations				
Revenue	1	261,346	241,870	483,120
Operating expenses		(249,601)	(226,645)	(459,543)
Group operating profit	1	11,745	15,225	23,577
Analysed as:				
Group EBITDA	1	34,746	32,701	63,146
Depreciation of property, plant and equipment	1	(12,227)	(11,035)	(24,192)
Amortisation of intangible assets	1	(10,774)	(6,441)	(15,377)
Finance costs		(6,499)	(4,991)	(13,220)
Finance income		35	52	261
Share of profit of associates		5	–	12
Profit before taxation		5,286	10,286	10,630
Taxation	3	1,941	867	13,339
Profit for the period from continuing operations		7,227	11,153	23,969
Discontinued Operations				
Loss for the period from discontinued operations		–	(670)	(578)
Profit for the period attributable to equity holders of the Company		7,227	10,483	23,391
Earnings per share from continuing operations				
Basic	4	1.41p	2.17p	4.66p
Diluted	4	1.41p	2.17p	4.66p
Earnings per share from total operations				
Basic	4	1.41p	2.04p	4.55p
Diluted	4	1.41p	2.04p	4.55p

Consolidated interim statement of recognised income and expense

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Exchange differences on translation of foreign operations	-	-	12
Cash flow hedges	(53)	520	895
Actuarial gains/(losses) on retirement benefit obligation	8,720	(6,547)	(3,166)
Tax on items taken directly to equity	(2,988)	801	(1,201)
Net income/(expense) recognised directly in equity	5,679	(5,226)	(3,460)
Profit for the period	7,227	10,483	23,391
Total recognised income and expense for the period	12,906	5,257	19,931

Consolidated interim balance sheet

	Unaudited As at 30 September 2007 £'000	Unaudited As at 30 September 2006 £'000	Audited As at 31 March 2007 £'000
Non-current assets			
Goodwill	193,245	179,838	192,754
Other intangible assets	40,793	36,072	48,511
Property, plant and equipment	133,625	127,846	132,385
Investments	860	857	854
Deferred tax assets	24,331	20,413	25,378
	392,854	365,026	399,882
Current assets			
Inventories	15,621	15,901	9,866
Trade and other receivables	98,447	85,771	88,087
Cash and cash equivalents	26,298	19,223	30,110
	140,366	120,895	128,063
Total assets	533,220	485,921	527,945
Current liabilities			
Trade and other payables	(141,885)	(126,211)	(138,234)
Non-current liabilities			
Bank loans	(198,800)	(169,867)	(193,383)
Retirement benefit obligations	(2,709)	(19,339)	(12,665)
Long term provisions and other payables	(5,670)	(4,601)	(6,062)
Total liabilities	(349,064)	(320,018)	(350,344)
Net assets	184,156	165,903	177,601
Capital and reserves, attributable to equity holders of the Company			
Share capital	51,526	51,480	51,493
Share premium account	352,657	352,360	352,450
Hedging and translation reserve	811	490	877
Retained earnings	(220,838)	(238,427)	(227,219)
Total equity	184,156	165,903	177,601

M D Abrahams, Chairman, P Simpson, Chief Financial Officer
26 November 2007

Consolidated interim cash flow statement

	Note	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Net cash flow from operating activities				
Operating profit	6	11,745	15,189	23,564
Adjustments for:				
Depreciation and amortisation		23,001	17,476	39,569
Increase in working capital		(12,641)	(12,166)	(4,114)
Employee share schemes		100	128	393
Gain on sale of property, plant and equipment		(125)	–	–
Income taxes paid		–	(76)	(284)
Net cash inflow from operations		22,080	20,551	59,128
Cash flows from investing activities				
Purchase of businesses		(319)	(20,110)	(43,064)
Purchase of property, plant and equipment		(16,424)	(11,593)	(23,721)
Proceeds from sale of property, plant and equipment		250	22	12
Purchase of intangible assets		(3,046)	(3,062)	(6,495)
Purchase of investments		–	–	(13)
Net cash used in investing activities		(19,539)	(34,743)	(73,281)
Cash flows from financing activities				
Dividends paid		(6,691)	(4,012)	(7,356)
Issue costs of long term loans		(230)	(86)	(1,416)
Interest paid		(4,687)	(4,574)	(11,496)
Interest received		35	118	261
Capital element of finance lease repayments		(280)	(115)	(301)
Repayment of bank loans		–	–	(13)
New loans		5,500	30,000	52,500
Net cash (used in)/from financing activities		(6,353)	21,331	32,179
(Decrease)/increase in cash and cash equivalents		(3,812)	7,139	18,026
Cash and cash equivalents at the beginning of the period		30,110	12,084	12,084
Cash and cash equivalents at the end of the period		26,298	19,223	30,110

Notes to the unaudited interim financial information

1. Segmental analysis

With effect from 1 April 2007, the Group has carried out an operational reorganisation of the business, in order to align the reported activities of each business segment with the markets which they serve.

As a result, the following segmental analysis for the period to 30 September 2006 and 31 March 2007 has been restated to reflect this reorganisation.

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 As restated £'000	Audited Year ended 31 March 2007 As restated £'000
Revenue			
Integration & Managed Services	139,889	134,549	270,959
Telecoms & Internet Services	122,258	110,087	222,666
Information Services	9,881	9,486	13,630
Other ⁴	(10,682)	(12,252)	(24,135)
Total – continuing activities	261,346	241,870	483,120
Discontinued activities	-	75	75
	261,346	241,945	483,195

Operating Margin

Operating margin represents gross margin before the deduction of depreciation and amortisation and excludes overheads and general and administration expenses. This additional information is an operational measure used by the Board in managing the financial performance of the business.

Integration & Managed Services	27,298	27,038	59,852
Telecoms & Internet Services	70,946	65,445	133,066
Information Services	5,906	5,664	7,322
Other ⁴	(7,859)	(10,149)	(19,532)
Total – continuing activities	96,291	87,998	180,708
Discontinued activities	-	45	45
	96,291	88,043	180,753

Group EBITDA

Integration & Managed Services	4,611	6,884	19,030
Telecoms & Internet Services	30,804	27,127	58,421
Information Services	4,190	3,840	3,684
Other ⁴	(3,690)	(4,156)	(10,163)
Total – continuing activities before exceptional items	35,915	33,695	70,972
Exceptional items:			
Integration & Managed Services	(520)	-	(57)
Telecoms & Internet Services	(187)	(54)	(1,781)
Information Services	(30)	(64)	(91)
Other ⁴	(432)	(876)	(5,897)
	(1,169)	(994)	(7,826)
Total – continuing activities	34,746	32,701	63,146
Discontinued activities	-	(36)	(36)
	34,746	32,665	63,110

⁴ Other includes head office costs, shared services and eliminations

Notes to the unaudited interim financial information continued

1. Segmental analysis continued

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 As restated £'000	Audited Year ended 31 March 2007 As restated £'000
Depreciation			
Integration & Managed Services	4,383	4,428	9,263
Telecoms & Internet Services	6,836	6,003	13,735
Information Services	236	249	502
Other ⁵	772	355	692
Total – continuing activities	12,227	11,035	24,192
Discontinued activities	–	–	–
	12,227	11,035	24,192
Amortisation			
Integration & Managed Services	4,603	2,900	7,734
Telecoms & Internet Services	5,680	2,841	5,828
Information Services	65	59	100
Other ⁵	426	641	1,715
Total – continuing activities	10,774	6,441	15,377
Discontinued operations	–	–	–
	10,774	6,441	15,377
(Loss)/profit from operations			
Integration & Managed Services	(4,375)	(444)	2,033
Telecoms & Internet Services	18,288	18,283	38,858
Information Services	3,889	3,532	3,082
Segment result – continuing activities before exceptional items	17,802	21,371	43,973
Exceptional items:			
Integration & Managed Services	(520)	–	(57)
Telecoms & Internet Services	(187)	(54)	(1,781)
Information Services	(30)	(64)	(91)
Other ⁵	(432)	(876)	(5,897)
	(1,169)	(994)	(7,826)
Segment result – continuing activities	16,633	20,377	36,147
Head office and other unallocated costs	(4,888)	(5,152)	(12,570)
Profit from continuing operations	11,745	15,225	23,577
Share of profit of associate	5	–	12
Profit from continuing operations	11,750	15,225	23,589
Segment result – discontinued activities	–	(670)	(578)
	11,750	14,555	23,011

⁵ Other includes head office costs, shared services and eliminations

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 As restated £'000	Audited Year ended 31 March 2007 As restated £'000
Capital expenditure on property, plant and equipment and intangible assets			
Integration & Managed Services	2,013	3,264	4,851
Telecoms & Internet Services	12,901	9,681	25,714
Information Services	71	95	299
Other ⁶	1,671	828	2,198
Total – continuing operations	16,656	13,868	33,062
Discontinued operations	–	–	–
	16,656	13,868	33,062

The split of total revenue between external customers and inter-segment revenue is as follows:

Revenue from external customers			
Integration & Managed Services	139,158	134,549	270,863
Telecoms & Internet Services	113,059	99,062	200,737
Information Services	8,778	8,236	11,472
Other ⁶	351	23	48
Discontinued operations	–	75	75
Total	261,346	241,945	483,195
Inter-segment revenue			
Integration & Managed Services	731	–	96
Telecoms & Internet Services	9,199	11,025	21,929
Information Services	1,103	1,250	2,158
Other ⁶	(11,033)	(12,275)	(24,183)
Total	–	–	–
	261,346	241,945	483,195

None of the revenue, operating profit or net operating assets arising outside the United Kingdom are material to the Group. The geographical analysis of revenue by destination is given below:

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Geographical analysis of revenue			
United Kingdom	259,088	239,447	468,288
Continental Europe	2,151	2,382	12,946
Other	107	116	1,961
	261,346	241,945	483,195

⁶ Other includes head office costs, shared services and eliminations

2. Exceptional items

Exceptional items are separately disclosed by virtue of their size or incidence to enable a full understanding of the Group's financial performance. Restructuring costs arise as a result of organisational changes following the integration of acquisitions. Onerous lease provisions arise as a result of continued rationalisation of the Group's property portfolio.

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Exceptional items			
– Restructuring costs	1,169	232	2,033
– Onerous lease provision	–	762	5,770
– Amounts written off investments	–	–	23
Charged to operating profit	1,169	994	7,826
– Accelerated loan fee amortisation	–	–	1,918
Charged to profit before taxation	1,169	994	7,826

3. Taxation

The taxation credit on continuing activities is set out below:

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Corporation tax	–	–	122
Deferred tax	1,941	867	13,217
Group total	1,941	867	13,339

There is an unprovided deferred tax asset in respect of accelerated capital allowances, which has decreased from approximately £20 million at 31 March 2007 (calculated at 30 per cent) to £13 million at 30 September 2007 (calculated at 28 per cent).

4. Earnings/(loss) per share

The calculation of basic and diluted earnings/(loss) per share and adjusted basic and adjusted diluted earnings/(loss) per share is based on the following numbers of shares and earnings:

	Unaudited Six months ended 30 September 2007 No.	Unaudited Six months ended 30 September 2006 No.	Audited Year ended 31 March 2007 No.
Weighted average number of shares			
For basic earnings/(loss) per share	514,135,201	513,917,990	513,941,128
Share options in issue	78,159	751,874	171,636
For diluted earnings/(loss) per share	514,213,360	514,669,864	514,112,764
	£'000	£'000	£'000
Earnings/(loss)			
Profit for the period attributable to equity holders of the Company	7,227	10,483	23,391
Adjustment to exclude loss for the period from discontinued operations	-	670	578
Profit for the period from continuing operations	7,227	11,153	23,969
Adjustments:			
Exceptional items	1,169	994	7,826
Accelerated loan fee amortisation	-	-	1,918
Amortisation of intangible assets arising on acquisitions	6,503	2,891	8,015
Taxation	(1,941)	(867)	(13,339)
Adjusted profit for the period from continuing operations	12,958	14,171	28,389
	pence	pence	pence
Earnings per share from continuing operations			
Basic	1.41	2.17	4.66
Diluted	1.41	2.17	4.66
Adjusted basic	2.52	2.76	5.52
Adjusted diluted	2.52	2.75	5.52
Loss per share from discontinued operations			
Basic	-	(0.13)	(0.11)
Diluted	-	(0.13)	(0.11)
Total earnings per share from continuing and discontinued operations			
Basic	1.41	2.04	4.55
Diluted	1.41	2.04	4.55

Notes to the unaudited interim financial information continued

5. Dividends

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Amounts recognised as distributions to equity holders in the period:			
Final dividend for the year ended 31 March 2006 of 0.78 pence per share	-	4,012	4,012
Interim dividend for the year ended 31 March 2007 of 0.65 pence per share	-	-	3,344
Final dividend for the year ended 31 March 2007 of 1.30 pence per share	6,691	-	-
Total	6,691	4,012	7,356

The proposed interim dividend for the six months ended 30 September 2007 is 0.94 pence per share. In accordance with IAS 10 'Events after the balance sheet date', dividends declared after the balance sheet date are not recognised as a liability in this set of interim financial information.

6. Reconciliation of operating profit

	Unaudited Six months ended 30 September 2007 £'000	Unaudited Six months ended 30 September 2006 £'000	Audited Year ended 31 March 2007 £'000
Group operating profit from continuing operations	11,745	15,225	23,577
Loss from discontinued operations	-	(36)	(36)
Loss on write-down of fixed asset investments	-	-	23
Total operating profit	11,745	15,189	23,564

7. Consolidated interim statement of changes in shareholders' equity

	Share capital £'000	Share premium account £'000	Hedging and translation reserve £'000	Retained earnings £'000	Total £'000
At 1 April 2006	51,480	352,360	(30)	(239,280)	164,530
Employee share schemes	–	–	–	128	128
Total income and expense recognised directly in equity	–	–	520	(5,746)	(5,226)
Profit for the period	–	–	–	10,483	10,483
Dividends	–	–	–	(4,012)	(4,012)
At 30 September 2006	51,480	352,360	490	(238,427)	165,903
Employee share schemes	–	–	–	265	265
Shares issued in the period	13	90	–	–	103
Total income and expense recognised directly in equity	–	–	387	1,379	1,766
Profit for the period	–	–	–	12,908	12,908
Dividends	–	–	–	(3,344)	(3,344)
At 31 March 2007	51,493	352,450	877	(227,219)	177,601
Employee share schemes	–	–	–	100	100
Shares issued in the period	33	207	–	–	240
Reclassification	–	–	(13)	13	–
Total income and expense recognised directly in equity	–	–	(53)	5,732	5,679
Profit for the period	–	–	–	7,227	7,227
Dividends	–	–	–	(6,691)	(6,691)
At 30 September 2007	51,526	352,657	811	(220,838)	184,156

8. Basis of preparation and publication of interim results

This interim financial information comprises the consolidated balance sheets at 30 September 2007, 30 September 2006 and 31 March 2007 and the consolidated statements of income, recognised income and expense and cash flows for the periods then ended and related notes of KCOM Group PLC, (hereinafter referred to as 'the financial information').

This interim financial information has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and with IAS 34, 'Interim financial reporting' as adopted by the European Union. In preparing this information management have used the accounting policies set out in the Group's 2007 financial statements.

The following new standards, amendments to standards or interpretations are mandatory for the financial year ending 31 March 2008:

- IFRIC 7, 'Applying the restatement approach under IAS 29', effective for annual periods beginning on or after 1 March 2006. This interpretation is not relevant for the Group
- IFRIC 8, 'Scope of IFRS 2', effective for annual periods beginning on or after 1 May 2006. This interpretation has not had any impact on the recognition of share-based payments in the Group

8. Basis of preparation and publication of interim results continued

- IFRS 7, 'Financial instruments: Disclosures', effective for annual periods beginning on or after 1 January 2007. IAS 1, 'Amendments to capital disclosures', effective for annual periods beginning on or after 1 January 2007. IFRS 4, 'Insurance contracts', revised implementation guidance, effective when an entity adopts IFRS 7. As this interim report contains only condensed financial statements, and as there are no material financial instrument related to transactions in the period, full IFRS 7 disclosures are not required at this stage. The full IFRS 7 disclosures, including the sensitivity analysis to market risk and capital disclosures required by the amendment of IAS 1, will be given in the annual financial statements

The following new standards, amendments to standards or interpretations have been issued, but are not effective for the financial year ending 31 March 2008 and have not been adopted early:

- IFRIC 12, 'Service concession arrangements', effective for annual periods beginning on or after 1 January 2008. Management do not expect this interpretation to be relevant for the Group
- IFRS 8, 'Operating segments', effective for annual periods beginning on or after 1 January 2009, subject to EU endorsement. Management do not currently foresee any changes to the Group's segmental analysis

This interim financial information does not constitute a set of statutory accounts under s.240 of the UK Companies Act 1985 and is unaudited. The comparative figures for the financial year ended 31 March 2007 are an extract from the Group's 2007 financial statements, which have been reported on by the company's auditors and delivered to the Registrar of Companies. These comparative figures have been restated where necessary for the operational reorganisation on 1 April 2007. The report of the auditors was unqualified and did not contain statements under section 237(2) or (3) of the UK Companies Act 1985.

This document (the Interim Report 2007/08) will be published on the company's website in addition to the normal paper version. The maintenance and integrity of the KCOM Group PLC website is the responsibility of the directors and the work carried out by the auditors does not involve consideration of these matters. Legislation in the UK governing the preparation and dissemination of accounts may differ from legislation in other jurisdictions.

9. Statement of directors' responsibilities

The directors confirm that this condensed set of interim financial statements has been prepared in accordance with IAS 34 as adopted by the European Union, and that the interim management report herein includes a fair review of the information required by DTR 4.2.7 and DTR 4.2.8.

The directors of KCOM Group PLC are listed in the KCOM Group Annual Report for 31 March 2007, with the exception of the following changes:

- Paul Renucci has joined the Board as Managing Director of Affiniti with effect from 26 November 2007
- Peter Halls, the current Executive Director for Affiniti, will step down from the Board on 20 December 2007
- Graham Holden has been appointed to the Board as a Non-Executive Director with effect from 26 November 2007, replacing Sean Christie as Chairman of the Audit Committee. Sean Christie is retiring from the Board with effect from 26 November 2007
- Paul Simpson, Chief Financial Officer, has, with effect from 26 November 2007, assumed responsibilities for company secretarial matters following the retirement of John Bailey
- John Carrington has taken on the role of Senior Independent Non-Executive Director with effect from 26 November 2007
- Gordon Wilson retired from the Board on 4 June 2007
- John Robinson retired from the Board on 5 June 2007

Independent review report to KCOM Group PLC

Introduction

We been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2007, which comprises the income statement, balance sheet, statement of recognised income and expense, cash flow statement and related notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 8, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has

been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of the Disclosure and Transparency Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information

consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2007 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

PricewaterhouseCoopers LLP
Chartered Accountants
Leeds

26 November 2007

