KCOM

Connected with our customers

KCOM Group PLC
Annual report and accounts 2017/18

Connected with our customers

By listening to and learning from our customers, we design and deliver the right services to help them create greater value from the way they interact, collaborate and connect with what matters to them.

Strategic report

Directors' report

Financial statements

See also

Online report
ar18.kcomplc.com

Highlights

Revenue
£ million

£301.9m

-8.9%

EBITDA[1,2]
£ million

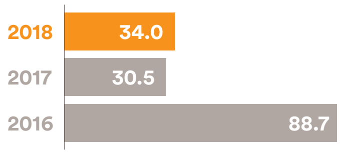
£68.3m

+1.0%

Profit before tax
£ million

£34.0m

+11.5%

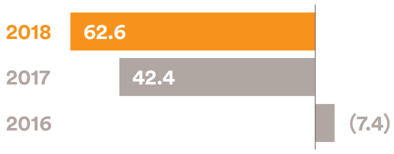


1. EBITDA is stated before exceptional items. All references to 'EBITDA' throughout the remainder of the report and accounts are before exceptional items, except where specifically highlighted in Note 4.
2. Refer to glossary on page 121 for Alternative Performance Measures (APMs).

Net debt/(funds)[2]
£ million

£62.6m

+47.6%



Proposed full year dividend
Pence per share

6.00p

Operational highlights

> Profit ahead of expectations despite lower revenue
  - EBITDA up 1% year on year, driven by multi-year network rates rebate, higher margins and strong cost controls
  - Lower revenue reflects anticipated decline in National Network Services

> Good progress in Hull & East Yorkshire
  - Revenue up 2% overall
  - Strong performance in Consumer channel, revenue up 4%
  - Full-fibre deployment on target to be available to 100% of addressable market by March 2019
  - More customers taking broadband over full-fibre now than over copper

> Margin and profit improvement in Enterprise, despite 3% revenue decline
  - Revenue affected by lower government spend, and previously identified software contracts
    - Two software contracts now exited; customer relationship maintained with new business in place
  - Strengthened management team driving momentum from cloud-based wins and renewals

> Statutory profit before tax increased by 11.5% reflecting lower level of exceptional costs partially offset by increased depreciation and amortisation

> Net debt increase reflects our capital investment, including continued investment in fibre

> Recommended final dividend of 4.00p, to deliver committed 6.00p per share dividend for the full year

> Existing dividend commitment extended to 2018/19 financial year

Our business at a glance

We make life easier and better for our customers

We help customers create greater value from the way they interact, collaborate and connect with what matters to them.

We operate in three markets:

Enterprise

Large enterprises and public sector organisations across the UK

£88.3m
revenue

National Network Services

Mid-sized UK businesses and public sector organisations

£113.2m
revenue

Hull & East Yorkshire

Residential consumers and businesses in Hull & East Yorkshire

£104.2m
revenue

See also

Our business model page 10

Market opportunities page 12

Our strategy page 22

Hull & East Yorkshire

What we offer
We provide internet-based services to households and businesses in Hull & East Yorkshire. Our flagship Lightstream broadband service offers customers a range of ultrafast speeds and data allowances to suit their needs.

What makes us different
- Our investment in market-leading, full-fibre broadband technology.
- Our deep understanding of our market and ability to engage closely with our customers.

Our customers
- **c140,000** homes
- **c7,000** small and medium businesses

Enterprise

What we offer
We help large organisations make the most of technology to serve customers better and adapt to a faster paced and more competitive environment. Our offering to this market includes Contact Centre as a Service and cloud-based services, from consulting and design to implementation and in-life, managed and support services.

What makes us different
- The breadth and depth of our cloud capability and experience.
- Our partnerships with market-leading technology providers.
- Our culture and flexible ways of working including the use of Agile methodologies.

Some of our customers
- Bupa
- HMRC
- Jaguar Land Rover
- NFU Mutual
- Rail Delivery Group

National Network Services

What we offer
We provide connectivity-based services to national organisations to support their business operations and provide a platform for market differentiation and competitive advantage. Our core services for this market include managed Wide Area Networks (WANs) and call management services.

What makes us different
- Our ability to offer a single, end-to-end managed service.
- Our cloud capability and applications expertise.

Some of our customers
- Domino's
- emPSN
- Furniture Village
- One Stop
- RSPB
- Staffordshire County Council

Key partners

- Amazon Web Services
- BT Group
- Cisco
- CityFibre
- Comms-care
- Daisy
- Egain
- Google
- ForgeRock
- Metaswitch
- Microsoft Azure
- Nuance

Chairman's statement

Sustainable value for our shareholders

> Continued progress:
- year on year growth in EBITDA and profit before tax
- recommended final dividend of 4.00 pence per share
- extending minimum dividend commitment of 6.00 pence per share for the year ending 31 March 2019

Dear Shareholder

In a challenging environment, we have made continued progress and have achieved year on year growth in EBITDA and profit before tax, ahead of our expectations. Our objective remains to deliver long-term sustainable value for our shareholders. The operating segments we established last year have allowed us to more clearly articulate our segments' goals and understand their individual performance and value. This leads to our continued refinement of the allocation of investment and resources.

Strategic focus

Our Hull & East Yorkshire performance this year was particularly pleasing, with our ultrafast fibre deployment firmly on target for completion next year and another strong performance secured in our key Consumer market. Enterprise delivered strengthened margins against a difficult backdrop, largely driven by an unexpected slowdown in government spending. We remain focused on capitalising on the growing trend for business applications moving to the cloud, our Enterprise team's greatest strength.

Board changes and effectiveness

We are making good progress with the important work to manage leadership changes within our business. We are well advanced in our search for a replacement for our CEO Bill Halbert, who is providing strong continuity whilst we complete that task. We have also announced the appointment of Anna Bielby as interim Chief Financial Officer on 1 July 2018 and have new leadership in place in Hull & East Yorkshire.

Throughout this period of change the Board has remained focused on its responsibility for the long-term success of the Group and each Director has contributed significant time and effort to ensure the continued effectiveness of the Board.

Graham Holden
Non-Executive Chairman

Dividend

I am pleased to confirm that the Board is recommending a final dividend of 4.00 pence per share which, if approved, will bring our full year dividend to 6.00 pence per share – in line with our commitment. We are extending the minimum dividend commitment of 6.00 pence per share for the year ending 31 March 2019.

Good governance and responsible business

Good governance is essential to the business and we seek to adopt best practice. During the year, we have maintained our ongoing dialogue with our major shareholders and we thank them for the valuable insight and appropriate challenge that they provide to members of the Board.

Last year was an exciting time for the city of Hull, as it celebrated being the UK City of Culture. As a major business in the region, we are proud to have played an important part in the programme. It was particularly pleasing to see over 30 of our employees participating in the City of Culture volunteer scheme, welcoming people from all over the world to the wide variety of cultural and artistic events. Already the city has benefited enormously from the investment in regeneration and a substantial increase in visitors to the area. We are very confident that it will leave a legacy well into the future.

> “
> **We are proud to have played an important part in Hull’s UK City of Culture programme.”**

As ever, we continue to operate in a rapidly changing environment. This presents both opportunities and challenges as we move forward with our strategy. Our people remain our most valuable asset and, as always, they have demonstrated energy and passion in delivering exceptional services to our customers. It is clear from the regular feedback we receive that they remain committed to making life easier and better for each and every customer.

We truly appreciate and thank them for their continued support as we move forward into the next phase of the Group’s development.

Graham Holden
Non-Executive Chairman
8 June 2018

CEO's statement

Execution of our strategy

- Sustainable momentum established across the business
- Future focus on:
  - completing our fibre deployment in Hull & East Yorkshire
  - building further market opportunities to maximise the value of our Enterprise capability


Bill Halbert
Chief Executive

Dear Shareholder

As stated by our Chairman, in his statement, our primary goal remains that of creating value, through attractive investment returns for our shareholders, together with continuing to develop an equally attractive and compelling prospect for all other key stakeholders in the business: our employees, customers, partners, public bodies, regulators and the communities in which we operate. I believe that thanks to the dedication and commitment of our employees, we have, despite the challenging conditions to which our Chairman refers, continued to make commendable progress on all fronts.

We have continued to execute against our operating plans – progressing our fibre deployment in Hull & East Yorkshire, improving brand awareness, market position and margins in Enterprise, and managing National Network Services for value. The respective segment strategies and plans were outlined at the Capital Markets Day on 1 February 2018, where we highlighted also the strengths of the Group and areas of focus. We provided further detail on our plans to invest in, and transform KCOM's network and other key assets and capabilities.

We have continued to establish sustainable momentum across the business:

- Overall Group profit performance was resilient, reflecting the strength of our Hull & East Yorkshire segment. EBITDA was £68.3 million (2017: £67.6 million) and statutory profit before tax was £34.0 million (2017: £30.5 million).
- Revenue (£301.9 million) was held back mainly by the anticipated decline in legacy activities within National Network Services. Enterprise experienced an unexpected slowdown in government spend and was affected also by previously disclosed software contract issues, but succeeded in delivering a strengthened margin performance, while achieving important new wins and renewals.

In order to maximise opportunities and returns in our Enterprise segment, the Board has adopted a higher appetite for risk than in our other go-to-market segments. From time to time risks will materialise. This year we have incurred contract losses of £5.3 million (2017: £3.7 million) with one particular customer. We have performed a review of both the factors which led to the issues encountered on these contracts, and the lessons learnt. This has resulted in a number of targeted improvements to the governance of our Enterprise contracts and a specific and ongoing transformation project to strengthen our project delivery capability.

Moving into the next financial year, we look forward to completing our fibre deployment in Hull & East Yorkshire and are focused on building further market opportunities to maximise the value of our growing Enterprise capability, particularly as customers continue the trend to move business applications into the cloud environment, an area of significant strength for our Enterprise team.

The operating segments we established in the prior year allow for a better understanding of segmental performance and clearer communication of their individual strategies through to performance. We will continue activity that will allow us to show greater granularity of segmental performance and value and to support further reductions in operating costs. As part of this, we will continue the investment in the transformation of our network as well as accelerating the simplification and upgrading of our IT estate. Those activities will incur further exceptional costs.

The combined output from those activities should enhance our ability to deliver long-term sustainable cash generation alongside future opportunities to maximise shareholder value.

“The operating segments we established in the prior year allow for a better understanding of segmental performance and clearer communication of their individual strategies through to performance.”

Outlook

We remain confident about our prospects in the medium-term. Our investment in network, systems and processes will underpin long-term sustainable value, greater understanding of segmental performance and a simplified operating model.

As we make fibre available to 100 per cent of our addressable Hull & East Yorkshire market over the next year, we will evaluate and develop the next wave of services to maximise returns on that investment.

In Enterprise, the investment we have made in management, key skills and partnerships is expected to generate growth in the medium-term adding to the already growing proportion of recurring revenues. We continue to manage National Network Services for value having tightened its strategic focus over the last year.

Bill Halbert
Chief Executive
8 June 2018

Our business model

Creating value from connections

Our key inputs

People
We want to provide an environment where we attract, retain, develop and enable all our people to demonstrate, grow and apply their capabilities, offering opportunities for everyone to reach their full potential.

Customers and Partners
We understand and anticipate the needs of our customers and align our products, services and solutions to meet those needs, leveraging our ecosystem as market-leading partnerships to create a unique and differentiated brand experience.

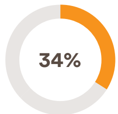
Systems and processes
Our organisation and customer experience is underpinned by robust processes and systems. The ability to understand, manage and interpret the data we hold is key to developing compelling propositions and providing clear and transparent information on segmental performance.

Assets
Our offerings to customers are underpinned by our technology platforms. We seek to invest in consolidating and transforming them to deliver new services and reduce operating costs and complexity.

See also
Our strategy
page 22

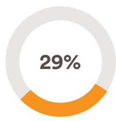
How we generate revenue

Hull & East Yorkshire
We provide communications and internet-based services to homes and businesses in the region.



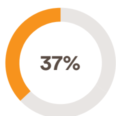
£104.2m
Hull & East Yorkshire revenue

Enterprise
We provide consulting, design, implementation and managed services related to Contact Centre as a Service and cloud-based business applications.



£88.3m
Enterprise revenue

National Network Services
We provide network connectivity and IT services and applications to businesses nationally.



£113.2m
National Network Services revenue

Opportunity	Stakeholder value creation
Investment Focused **Outcome** Income	**For shareholders** Our operations in Hull & East Yorkshire deliver strong income and cash generation that allow us to make a clear sustainable dividend commitment. **For customers** We help consumers and businesses in Hull & East Yorkshire live and work in a digital world.
Investment Light / customer funded **Outcome** Growth	**For shareholders** We are well positioned to compete in the Enterprise market. Our strategy in this market represents a strong growth opportunity by creating an asset-light, margin-rich revenue stream. **For customers** We help enterprises improve their business performance, including in particular the experience they offer customers.
Investment Targeted **Outcome** Manage for value	**For shareholders** We drive value from our national network platforms. **For customers** The connectivity-based services we provide to national businesses help them operate more efficiently.

Value created

For shareholders

6.00p

Proposed full year dividend (pence per share)

For customers

164,000

Premises passed by our Hull & East Yorkshire fibre deployment

Employee engagement

We offer personal growth and development opportunities across a wide range of disciplines. Our reward and recognition packages are closely aligned to business and personal performance.

For KCOM

Income and capital growth

£34.0m

Profit before tax

See also
Sustainability
page 35

Market opportunities

Hull & East Yorkshire

Supporting customers to live and work in a connected world

Maximising the value of our fibre investment

Growth opportunities are based primarily on the substantial investment we have made in the deployment of full-fibre broadband across our Hull & East Yorkshire network. We plan to maximise those opportunities by continuing to increase take-up of our ultrafast Lightstream fibre services and by offering additional services that allow us to make returns on this investment.

The main areas for growth are:

> Broadband and voice
> The in-home/office experience
> Mobility
> Cloud services
> Wholesale

1 Broadband and voice

As we continue our deployment of full-fibre broadband to the remainder of our network, we are encouraging customers to migrate from standard broadband delivered over copper to our ultrafast fibre Lightstream services. We can see, through the insight captured to date, that those services provide better quality access to the internet as evidenced by higher customer satisfaction and lower fault rates. We have used customer insight to refresh our broadband portfolio and give customers greater flexibility to personalise their service by choosing a download speed and data allowance that suits their needs. Rather than having to pay for inclusive calls they may not use, customers buying from the new portfolio can opt for pay-as-you-go calls or select from a range of bolt-on call packages.

2 The in-home/office experience

While our Lightstream services deliver ultrafast broadband to the property, we know that customers can receive a less than optimal broadband experience in the home or office as a result of factors affecting their Wi-Fi signal and setup. As well as providing self-help information to customers about what they can do to ensure the best possible Wi-Fi experience we have begun trialling services such as Wi-Fi health checks and signal boosting services that may offer future commercial opportunities while increasing customer satisfaction.

For Hull's award-winning Atom Brewery, the internet is an essential means of spreading the word about its science-inspired beers, which include Schrodinger's Cat, Quantum State and Pulsar. In the three years since it was established Atom has expanded to supply customers in all four corners of the world. Last year alone it produced 34 beers and sold more than 230,000 pints to ale lovers as far afield as Australia and Lapland.

> **"Our customer base is predominantly millennials, aged from 25 to 40, who gather their information from social media like Instagram, Twitter and Facebook. That means we need to be able to access the internet 24/7 and we need it to be reliable. KCOM gives us that."**

Allan Rice
Founder, Atom Brewery

3 Mobility

Although the stand-alone mobile market is highly competitive and commoditised we believe there are opportunities for us to provide mobility services as an extension of our fibre network coverage to drive additional customer acquisition. We are in the early stages of exploring how we might develop a compelling and differentiated mobility proposition for customers in the region.

While this work takes place, we will focus on expanding our current mobile offering to address the needs of our core customer segments. This will give us a solid platform from which to extend our capability and differentiate it by blurring the boundaries between the fixed data we provide customers over our fibre network and the mobile data they use while on the move.

4 Cloud services

The high level of trust and deep relationships we enjoy with our business customers mean we are well positioned to support them in their transition to cloud communications services. Our target market for these services is businesses with 10–50 employees, for whom subscription-based services are more attractive than on-premises services that require upfront investment.

Lack of internal IT expertise within these businesses means the cloud services we offer need to be easy to understand, easy to buy and easy to manage. Currently we offer a cloud voice solution alongside Microsoft Office 365 and are working with partners including Microsoft and Cisco to develop other cloud propositions including a managed security tool.

5 Wholesale

Our aim within the Hull & East Yorkshire wholesale market is to be the partner of choice for other providers by offering a range of access products that deliver best value. We have recently refreshed our Ethernet pricing and introduced new fibre access products to achieve this.

Our future focus includes expanding our offering to include more flexible branch network solutions that allow our partners to implement more readily new services to their customers in the region.

Refining our value proposition

Driving Lightstream take-up and providing complementary services are key to exploiting our fibre investment and in order to maximise the benefits of these activities we are optimising the strategy in Hull & East Yorkshire.

This will create a strong commercial platform for strengthening and expanding our portfolio with complementary value-added services. It will ensure we are in the best possible position to continue to satisfy customer needs and achieve growth.

Market opportunities continued

Enterprise

Using technology to help customers solve tomorrow's complex problems

Supporting organisations to navigate change

Today's enterprises, both public and private sector, operate increasingly in an environment where the need to respond ever more quickly to rising expectations, competition and regulations is driving a need for the flexibility and adaptability to address continuous change. This compels enterprises to invest in technologies to support and accelerate digital transformation.

We have the combination of capabilities and world-leading partnerships required to take advantage of the fast-growing market for technology enabled business solutions. Our propositions are focused on two categories:

> Contact Centre as a Service

> Cloud services, incorporating cloud native innovation, migration services, identity management services, analytics and multi-cloud managed services

1 Contact Centre as a Service

As customers increasingly expect seamless communication with organisations through both traditional and digital channels, enterprises are seeking to achieve this through the introduction of flexible, Contact Centre as a Service cloud platforms and omni-channel capabilities.

Our strong omni-channel proposition and track record, combined with our technology partnerships, means we are well positioned to continue to win business in this market.

2 Cloud services

Through our cloud expertise we help enterprises develop applications and the infrastructure behind them in a way that is faster, less costly and far more flexible than is possible with traditional IT services. Whether customers are moving from on-premises technology to the private cloud, from private cloud to hybrid cloud or from hybrid cloud to the public cloud, we can support them on their journey.

NFU Mutual chose KCOM to create a new claims vendor portal platform and infrastructure within the Microsoft Azure public cloud. As well as better engagement with suppliers and improved communication with customers regarding the status of their claim, the new platform can be scaled quickly and easily to handle peaks and troughs in demand.

> **“Our new cloud-based system means that when a customer makes a claim, for example for a damaged windscreen, our process for our operations teams is smoother and allows for better communications with customers throughout their claims journey.”**
>
> **Tim Mann**
> CIO, NFU Mutual

Our cloud propositions include:

- **Cloud native innovation:** we develop applications using features only available in the public cloud. Our current offering includes strategy and development, architecture, Platform as a Service and microservices; future propositions will include bespoke ‘born-in-the-cloud’ applications.
- **Migration services:** our migration of traditionally hosted IT infrastructure to a cloud environment allows customers to make the most effective move to the public cloud at a pace to suit them. Our migration services include cloud architecture, cloud connectivity and individual workload migrations.
- **Identity management services:** we provide centralised sign-on for multiple and distributed systems, with identities and access rights stored centrally and securely. We deploy software from market-leading global partners to deliver voice biometrics and identity and access management on private or public cloud platforms. We anticipate that open banking and new regulations around data protection will increase demand for these services.
- **Analytics and Internet of Things (IoT):** using public cloud platform architecture we turn vast quantities of complex data into valuable business insights. Today we deliver large-scale platform analytics architecture and IoT projects; future developments include a template analytics platform toolkit that will enable us to create standard tools quickly and easily.
- **Multi-cloud managed services:** we already combine expertise in cloud platforms, on-premises platforms and connectivity to provide managed services including problem management and break/fix support. We are developing enhanced services such as cost optimisation and the provision of technical design authority services.

Agile delivery

Organisations increasingly need to be agile to meet the changing expectations of customers. Growth in the market for cloud services is being driven both by this and by the increasing complexity of projects and the lack of specialist in-house skills. In pursuing new business, the depth and breadth of our technology expertise means we are competitive with both cloud specialists and large professional services organisations, while in delivering client projects we are increasingly benefiting from our adoption of Agile methodologies.

Market opportunities continued

National Network Services

Connectivity to support organisations on their technology journey

Connectivity is key

The connectivity solutions we deliver to customers in our National Network Services segment are critical to their business operations, underpinning in turn the services provided to their own customers and helping to create a platform for market differentiation and competitive advantage.

Within this segment our opportunities for growth are focused in three areas:

> Managed Wide Area Networks
> Health and Social Care Network
> Call management

1 Managed Wide Area Networks (WANs)

Our key target market for this proposition is organisations in the retail, charity, logistics and public sectors with 50–200 connected sites, where we have proven capability and strong client references. The challenges faced by such organisations include the growing constraints on their networks as a result of cloud adoption and the increasing bandwidth usage that is being driven by the adoption of business applications and video. As well as reliable connectivity solutions, our offering to this market includes:

> The ability to integrate with third party networks and provide a single, end-to-end managed service.
> Software defined networking (SD WAN) technology, which allows us to offer more resilient and more flexible services that enable customers to increase bandwidth in line with demand.
> 'Intelligent edge' services that allow network data to be analysed to give customers a deeper insight into how the network is being used.

The RSPB is the largest nature conservation charity in the UK, working to preserve wildlife both in the United Kingdom and overseas. It chose KCOM to provide a managed wide area network connecting 190 sites, some in very remote locations, across the UK.

With reliable connectivity in place, it made the decision to move to a KCOM hybrid cloud platform, providing the flexibility to make the most of videoconferencing services, improve internal communication and collaboration and reduce staff travel time.

"As our managed WAN provider, we trust KCOM with the end-to-end connectivity for 190 sites. We also trust its technology recommendations – adopting hybrid cloud has improved our audio and video conferencing capability, which has had a positive impact on communication within the business."

Luke Ludford
Infrastructure Support Manager, RSPB

2 Health and Social Care Network (HSCN)

HSCN is a new NHS Digital data network that has been designed to meet the needs of an integrated and evolving health and social care sector. Unlike the single-supplier network it is replacing, HSCN allows organisations including NHS trusts, pharmacies and GP surgeries to buy connectivity services from a choice of accredited suppliers within a competitive marketplace. These organisations tend to be cost-conscious and in need of simple solutions, reliable project management, seamless migration and in-life support.

We are among a small number of providers so far that has achieved level 2 HSCN compliance and already have a number of opportunities in the pipeline. We are well-placed to use our WAN expertise to support health and care providers to do more than simply migrate their existing data connections to the new network.

Our proposition is that by integrating customers' HSCN requirements within a wider network strategy we can improve the resilience, performance and security of their IT infrastructure and ensure their network has the flexibility and capacity to support future needs. This proposition is enhanced by our cloud capability and our applications delivery experience.

3 Call management

Our call management solutions enable complex call routing and multi-channel contact capabilities that allow organisations to manage the contact experience they deliver to customers. We have a strong track record in the provision of these services to the wholesale and reseller markets, where a key element of our offering is support and education on how their call management solution can best be deployed and shaped to meet the needs of their customers.

We are increasingly seeing opportunities to cross-sell our call management solutions to existing direct customers and will continue to evolve our portfolio enabling us to offer services including unified communications, mobility, payment card industry compliant voice services and voice biometrics capability to wholesale, reseller and direct customers.

Consultancy, delivery, service and support

Across our three key National Network Services propositions our focus is on offering customers a service wrap that includes pre-sales consultancy and advice, strong project management and delivery capability, together with in-life service and support.

This, combined with our ability to take advantage of the cloud and the integration expertise that sits within our Enterprise segment, enables us to offer added value to our customers, positioning us well to secure contract renewals as well as new and profitable business.

Performance review

Further progress

> EBITDA up 1% year on year despite lower revenue

> Increase in statutory profit before tax of 11.5%

> Strong net debt performance

Group performance

The results for the year show an increase in EBITDA (up 1% to £68.3 million) and an anticipated decline in Group revenue (down 9% to £301.9 million), largely driven by the expected decline in National Network Services.

Our Hull & East Yorkshire segment continues to perform well and during the year we saw growth across core channels, supporting the cash generation of the Group. Fibre take-up remains strong and we have reached the milestone where more of our broadband customers are taking the service on fibre than on copper.

Despite some in-year challenges, the Enterprise segment offers an important opportunity for growth. We are continuing to develop and refine the articulation of our propositions and to win the trust of new and existing customers, with a particular emphasis on our core capabilities around cloud-based implementation and Contact and Collaboration services.

Our National Network Services segment has seen an expected reduction in both revenue and contribution. We will continue to manage this segment for value focusing on growing those areas where we can differentiate our propositions.

In the year ended 31 March 2017, we refined our operating segments in order to report three distinct customer segments, namely; Hull & East Yorkshire, Enterprise and National Network Services. Those segments allow for a better understanding of segmental performance and clearer communication of the Group's strategy through to performance. As communicated at our recent Capital Markets Day each segment has a clearly defined go-to-market plan, under the common KCOM brand. We began an exercise midway through last year to allocate our shared costs to the go-to-market segments, in order to understand more clearly performance at this level. Certain costs are more easily allocated at a segment or customer level. Other costs (such as network and IT infrastructure) are more difficult to allocate due to their nature and also the complexity of our processes and systems. We have allocated those costs based on our best available information.

Jane Aikman
Chief Financial Officer

> Our Hull & East Yorkshire segment continues to perform well and during the year we saw growth across core channels."

This significant piece of work continues, with the next stage focused on a better understanding of our market segments in order to enable us to maximise value. With that in mind, and to continue to drive down our costs, we are investing in the transformation of our network and are accelerating the simplification and upgrading of our IT estate. We expect capital expenditure to peak next year as we focus on those important investments.

Exceptional items show a net credit of £0.7 million (2017: £8.0 million charge) due to a regulatory settlement and a reduction in the level of restructuring costs. In the prior year, we saw a high level of exceptional restructuring costs (2017: £7.3 million) as we undertook significant transformation in order to create a simplified Group with an appropriate cost base and investment aligned to market opportunities. Transformation activities continued through the year although we have incurred much lower restructuring costs (2018: £1.6 million).

In line with our accounting policy, regulatory items are shown as exceptional. Restructuring items are shown as exceptional, where they relate directly to the transformation of the business. After careful consideration the directors believe that the following two items should not be classified as exceptional:

> Contract losses relating to certain complex software contracts in our Enterprise segment (£5.3 million). These have been excluded from exceptional items since they arose as part of the normal course of business.

> Multi-year rebate on network infrastructure hereditament (rateable value) (£4.4 million). This has been excluded from exceptional items since we expect items of this nature to occur from time to time in the ordinary course of business. In addition, previous charges (for which the rebate has been awarded) were themselves not exceptional items and therefore presentation of the rebate as exceptional would not assist comparisons with previous periods.

Year end net debt was £62.6 million (31 March 2017: £42.4 million), with the increase on the prior year largely a result of capital investment, including the continued investment in the Hull & East Yorkshire infrastructure.

Segmental analysis

Management makes decisions and manages the business in line with the segmental analysis set out below. This information is presented before exceptional items in order to provide a better understanding of underlying performance. A reconciliation of the Group's pre-exceptional results is set out in Note 4. The definition of contribution is set out in the glossary on page 121.

Hull & East Yorkshire

	Year ended 31 March 2018 £'m	Year ended 31 March 2017 £'m
Revenue		
Consumer	**58.5**	56.1
Business	**30.5**	29.6
Wholesale	**10.8**	11.0
Core channels	**99.8**	96.7
Media	**1.9**	2.4
Contact Centres	**2.5**	3.2
Total revenue	**104.2**	102.3
Gross margin	**85.4**	78.5
Contribution	**65.7**	60.4

The Hull & East Yorkshire segment performed strongly during the year and has progressed in line with the strategy.

Consumer revenue has increased by 4% compared to the prior year. Our fibre deployment has enabled us to access more customers, with a net additional 2,700 broadband (copper and fibre) customers during the year.

Key metrics relating to our broadband market are as follows:

	31 March 2018	31 March 2017	Change
Overall broadband penetration of customer base (fibre and copper) %	85%	83%	2 percentage points
% of broadband customers taking fibre service	54%	33%	21 percentage points
Broadband Average Revenue Per User Per Month (£) (ARPU)	£35.17	£33.77	4%

The success of our ultrafast Fibre to the Premise offering continues. A summary of our progress is below:

	31 March 2018	31 March 2017
Total fibre availability (premises passed)	164,000	137,000
Total number of fibre customers (including businesses)	67,000 (3,500)	41,000 (2,800)
Availability delivered during current year (premises passed)	27,000	45,000
Premises connected to fibre during year (net)	24,000	19,000

Performance review continued

Hull & East Yorkshire continued

Within our fibre enabled areas, 64% of customers are taking a fibre service.

We expect to complete our full-fibre deployment by March 2019 at a total cost of c£80.0 million, a further c£5.0 million will be incurred in 2020 in order to continue to connect customers.

Business revenue has increased by 3% compared to the prior year. This growth has been underpinned by our fibre proposition with a further 700 business customers connected in the year, alongside an increase in project revenues.

Our Wholesale channel has reported broadly flat revenue with some stabilisation in the rate of decline seen in previous years.

As anticipated and signalled previously, our non-core Media and Contact Centres revenues have continued to decline. We closed our outsourced Contact Centres on 31 March 2018 following the end of our largest customer contract.

Contribution has increased compared to the prior year, with the current year including the benefit of a multi-year rebate on network infrastructure hereditament (rateable value) (£4.4 million). The prior year results include a one off supplier credit (£1.0 million).

Enterprise

	Year ended 31 March 2018 £'m	Year ended 31 March 2017 £'m
Revenue		
Projects	**35.5**	48.3
Managed Service	**39.8**	30.5
Network	**13.0**	12.2
Total revenue	**88.3**	91.0
Gross margin	**29.9**	25.6
Contribution	**5.1**	4.5

Overall revenue for the year decreased by 3% year on year. This principally relates to Projects where revenue was affected by lower public sector spending (as a result of the UK General Election and Brexit), alongside the mutually agreed exit of two previously identified complex software contracts, which incurred contract losses of £5.3 million (2017: £3.7 million). Following the mutual exit of these contracts, we continue to work with this customer on new projects.

Despite the challenges above, we continue to see the translation of prior year Project activity into annuity-based revenue through existing relationships. We continue to build relationships with key customers such as HMRC and NFUM both of whom have renewed and extended contracts during the year. Revenue from our top five customers has grown by 5% compared to the prior year.

Contracts were signed with a number of new customers including Jaguar Land Rover, InterDigital, SES Water and ITSO, all of which exploit our cloud capability. We have now joined the Google Cloud Partner Programme adding to our strong relationships with Amazon Web Services and Microsoft Azure.

> **"Contracts were signed with a number of new customers including Jaguar Land Rover, InterDigital, SES Water and ITSO, all of which exploit our cloud capability."**

We have continued to invest in the Enterprise management team and delivery capability which has driven an increased contribution through higher gross margin alongside tighter cost control.

National Network Services

	Year ended 31 March 2018 £'m	Year ended 31 March 2017 £'m
Revenue		
SMB	**51.9**	52.6
Partners	**33.9**	41.8
Large Corporate	**27.4**	47.4
Total revenue	**113.2**	141.8
Gross margin	**32.0**	41.0
Contribution	**9.0**	20.0

As anticipated, we have seen a decrease in revenue compared to the prior year. The majority of this decline has come from Large Corporate customers taking legacy services which we no longer sell. There has also been a reduction in Partners revenue relating to anticipated customer churn, alongside the continuing industry wide change in the mix of services in intelligent numbering (e.g. the movement to 03 numbers). As a consequence of this, contribution also reduced compared to the prior year.

During the year, we have tightened our focus on the larger end of the mid-market (SMB), where we can provide more value. We have seen continued success in the provision of managed Wide Area Network (WAN) connectivity services to multi-site organisations, including the deployment to 900 retail convenience stores nationally for One Stop Stores.

We are now focusing on core customer segments supporting the provision of WANs, a specific public sector opportunity relating to the delivery of Health and Social Care Networks (HSCN) and call management services.

Central

Central costs include PLC and corporate costs, where allocation to the underlying segments would not improve understanding of those segments. These include costs associated with our defined benefit pension obligations and share schemes, along with the residual Group cost of finance, HR, risk, legal and communications, once appropriate recharges have been made to the three go-to-market segments.

Central costs have decreased from £13.2 million in the prior year to £11.5 million, largely as a result of headcount reduction.

EBITDA reconciliation

A reconciliation of EBITDA to its closest statutory measure (profit before tax) can be found in the glossary on page 121.

Exceptional items

The Group benefited from a net exceptional credit of £0.7 million during the year. This comprises:

> a credit of £2.4 million from an industry wide settlement which arose as a result of a breach in BT Openreach's contractual and regulatory obligations relating to compensation for misapplying 'Deemed Consent'; offset by

> restructuring costs of £1.6 million including redundancy costs for the closure of our outsourced Contact Centre business and the improvement of our project delivery capability in line with our strategic growth plans.

Capital investment

Cash capital expenditure during the period was £43.9 million (2017: £47.2 million), slightly below previous guidance. The major project in the period was the continued deployment of fibre in Hull & East Yorkshire.

We expect capital expenditure to peak (to c£50.0 million) in the year ending 31 March 2019 due to continued investment in transforming our network and improving our underlying systems and processes, in part to allow greater understanding of segmental performance.

The Group's depreciation and amortisation charge for the period is £32.6 million (2017: £26.9 million), the increase resulting from the higher capital investment in recent years, which has an ongoing impact on profit before tax.

Net debt and cash flow

Year end net debt is £62.6 million (31 March 2017: £42.4 million), representing a net debt to EBITDA ratio of 0.9x.

The increase in net debt compared to the prior year end position arises principally as a result of dividend payments and continued capital investment (in particular fibre deployment in Hull & East Yorkshire).

Trade debtors and creditors continue to be well controlled. Days' Sales Outstanding (30) is broadly consistent with the prior year (27) and our Days' Purchases Outstanding shows a slight increase on the 31 March 2017 position. Our underlying working capital[1] movement shows a small outflow of £2.4 million which reflects the timing of one significant customer's payments at the year end compared to the prior year.

1. Underlying working capital – see more within our APMs on page 121.

Dividend

The Group's proposed final dividend is 4.00 pence per share (31 March 2017: 4.00 pence), which is consistent with the Board's previously stated commitment to pay a total dividend of no less than 6.00 pence for the year ending 31 March 2018. The dividend will be paid on 3 August 2018 to shareholders registered on 22 June 2018. The ex-dividend date is 21 June 2018.

Pensions

The year end IAS 19 pension liability is £7.5 million (31 March 2017: £19.7 million). The decrease from 31 March 2017 principally arises as a result of slight changes in assumptions (£3.5 million) alongside contributions to the schemes (£9.5 million).

The agreed level of deficit repair payments across both schemes is £6.7 million (rising in line with CPI until the year ending 31 March 2020 for the Data scheme and 31 March 2022 for the Main scheme). In addition, the Group makes pre-agreed payments to its pension schemes through the asset backed partnership. The full year payment for both the current year and prior year is £2.7 million.

Tax

The Group's tax charge including the impact of prior year items is £6.6 million (2017: £5.7 million). The effective tax rate is 19.3%, broadly in line with the prevailing rate of corporation tax.

Jane Aikman

Chief Financial Officer
8 June 2018

Driving operational excellence

Our value creation is underpinned by four strategic pillars

Customers and Partners

We understand and anticipate the needs of our customers and align our products, services and solutions to meet those needs, leveraging our ecosystem of market-leading partnerships to create a unique and differentiated brand experience.

Priorities for 2017/18

We aimed to:

> Introduce new propositions for consumers, business and wholesale partners in our Hull & East Yorkshire market;

> Enhance the experience of our customers in our Hull & East Yorkshire market by making improvements to buying, fault resolution and billing processes;

> Develop and launch a refreshed in-home service experience for customers in our Hull & East Yorkshire market;

> Leverage our track record with key reference clients to win new customers for complex contact and cloud-based projects;

> Seek to expand further our relationships with existing customers and partners; and

> Review our long-established partnership with BT to ensure that it remains fit for purpose to meet our future needs.

Progress for 2017/18

We have:

> Introduced a refreshed, flexible 'pick and mix' of speed and data fibre broadband packages for consumers, new cloud-based services for businesses and updated our wholesale packages for resellers in the Hull & East Yorkshire market;

> Exited the outsourced contact centre market following the end of our key customer contract;

> Secured cloud business with new clients including Jaguar Land Rover and InterDigital;

> Grown revenue with our top five Enterprise customers by five per cent, including contract renewals and extensions with HMRC and NFU Mutual; and

> Exited the outsourced managed service contract with BT, and integrated these services within the new operational structure to optimise the customer service experience.

Priorities for 2018/19

We will:

> Continue to develop our range of services that leverage our investment in the fibre network in Hull & East Yorkshire;

> Launch additional cloud-based services to our regional business customers, including offerings based on our partnerships with Microsoft Azure, Cisco and Google;

> Develop further our relationships with new and existing cloud partners including AWS, Microsoft and Google; and

> Review and improve contract management around our customers and partners.

People

We want to provide an environment where we attract, retain, develop and enable all our people to demonstrate, grow and apply their capabilities, offering opportunities for everyone to reach their potential.

Priorities for 2017/18

We aimed to:

> Move away from a recognition culture based on length of service and introduce a modern recognition platform that provides more transparent and relevant opportunities for reward and recognition;

> Make the most of the professional communities we have established to improve workforce planning, succession planning and talent management processes;

> Develop academies for all our professional communities, providing clear development solutions and pathways to support ownership of development by the individual; and

> Drive benefit from a broad, company-wide resource pool of skilled talent that allows for focused and effective utilisation and prioritisation.

Progress for 2017/18

We have:

> Introduced our 'Stars' recognition portal that allows our people to thank and recognise colleagues for their contribution;

> Transformed our delivery and project management capability with clearer career paths, consistent ways of working, knowledge management and development opportunities;

> Continued to refine the operation of our skilled resource pool to match capability and accretion of skills to future customer and proposition requirements;

> Aligned certain central functions more closely to Hull & East Yorkshire, Enterprise and National Network Services to drive segmental performance; and

> Introduced a regular feedback and engagement platform which gathers insight from around the business.

Priorities for 2018/19

We will:

> Use the insight from our online feedback platform to drive continuous improvement and greater employee engagement across the business;

> Develop and implement initiatives to achieve greater gender balance across our business to encourage more women to take up leadership positions and to apply for technical and engineering roles; and

> Continue to develop our delivery community to increase our ability to fulfil complex customer projects, focusing in particular on building our project management capability and our people management skills.

Systems and processes

Our organisation and customer experience is underpinned by robust processes and systems. The ability to understand, manage and interpret the data we hold is key to developing compelling propositions and providing clear and transparent information on segmental performance.

Priorities for 2017/18

We aimed to:

> Consolidate and build resilience into our existing IT systems and processes;

> Invest in technology to improve the customer experience at each customer touchpoint from order to delivery; and

> Provide greater granularity of segmental performance through the way we allocate costs.

Progress for 2017/18

We have:

> Delivered system enhancements that improve the experience of customers in our Hull & East Yorkshire market, including an engineering mobility and scheduling system that increases the efficiency of our engineering workforce in Hull & East Yorkshire and improves the experience customers receive during new service installations and fault repairs;

> Invested in systems that allow us to align our IT system delivery roadmap with business goals and strategies;

> Continued work to refine the allocation of shared costs to our segments to provide greater granularity and understanding of their performance and value; and

> Developed an accelerated investment plan to simplify and upgrade our IT estate, to deliver the business capabilities needed to support KCOM as a digital business.

Priorities for 2018/19

We will:

> Deliver on the first year of our accelerated investment plan to simplify and upgrade our IT systems supporting our focus on customer experience and provide greater clarity around the systems dependencies of each of our segments;

> Continue the implementation to automate our ordering and fulfilment processes in Hull & East Yorkshire, making more information available to help customers;

> Begin the delivery of our new ticketing and service management capabilities, adding to our engineering mobility and scheduling, and supporting the further development of our Customer Services Operations Centre;

> Continue to extend the capabilities supporting our sales team, and our large project delivery teams in Enterprise to further improve our end-to-end business processes; and

> Make further improvements to the presentation and content of account information for customers in Hull & East Yorkshire.

We are likely to incur exceptional costs in relation to our investment in systems and processes next year.

Assets

Our offerings to customers are underpinned by our technology platforms. We seek to invest in consolidating and transforming them to deliver new services and reduce operating costs and complexity.

Priorities for 2017/18

We aimed to:

> Create a single centre of excellence for our first line technical support teams with a new set of diagnostic tools and capabilities within our Customer Services Operation Centre; and

> Design a programme of network transformation covering all our assets nationwide. This includes a plan to consolidate our data centre estate, simplify our national network architecture and move to a next-generation voice platform in Hull & East Yorkshire.

Progress for 2017/18

We have:

> Invested £18.0 million in the year in order to pass a further 27,000 properties with ultrafast fibre as part of our ongoing investment across Hull & East Yorkshire;

> Transferred the first wave of technical support resource into the Customer Services Operations Centre focused on Hull & East Yorkshire and Enterprise technical support;

> Approved various network transformation cases, contracted with suppliers and partners, and commenced installation and commissioning. Some new next generation technologies are now carrying traffic; and

> Begun to optimise our existing data centre estate, and entered into an agreement with Hull University to construct a new data centre in Hull, which will form part of the KCOM data centre strategy once operational.

Priorities for 2018/19

We will:

> Complete the deployment of Fibre to the Premises across our addressable market in Hull & East Yorkshire and offer a voice over fibre integration to eliminate the need for copper cables into customer premises;

> Continue to transfer resource and skills into the Customer Services Operations Centre, complemented with new systems and processes designed to improve customer service and operational efficiency;

> Continue the network transformation programme, completing: the next-generation (NG) Transmission, NG Service Creation Platform, NG Value Added Services projects, and migrating much of the voice customer base to NG Voice platform for Hull & East Yorkshire and National Network Services;

> Continue to optimise our existing data centre estate, collaborate in building a new data centre with Hull University and commence integration with wider operations; and

> Achieve better visibility of network costs by segment.

Our work in this area is likely to incur exceptional costs next year.

Key performance indicators

Managing our performance

We track a series of metrics that indicate the progress we are making against our strategic objectives

Financial

Revenue
£ million

£301.9m

-8.9%

This statutory measure reflects the total amount the Group recognises from the sale of goods or services. Revenue recognition has been a particular area of focus this year given the introduction of IFRS 15 from 1 April 2018.

Revenue is a key measure of the Group's growth and progression and it is important that the business progresses with the right sort of revenue, for example exploiting the benefits of fibre in Hull & East Yorkshire and exploiting growth opportunities in Enterprise.

Revenue has reduced for the past two years in the main due to the continuing, and anticipated, decline in legacy business in our National Network Services segment.

Revenue performance in this area is slightly below our target, particularly due to the performance of our Enterprise segment. Despite this we are confident in our strategy as set out on pages 22 and 23.

The risks to achieving our performance metrics are set out on pages 28 to 34.

This KPI supports the long-term strategy of the Group.

EBITDA
£ million

£68.3m

+1.0%

Earnings before exceptional items interest, tax, depreciation and amortisation.

EBITDA is the key profit indicator used by the Group to track and assess underlying performance. This is reported monthly to the Executive Leadership Team (ELT) and the Board.

This profitability measure is also a key remuneration metric used for the Group bonus scheme. Further details are shown in the Remuneration report and within the definition of our Alternative Performance Measures.

Our EBITDA has increased year on year due to continued progression in our Hull & East Yorkshire segment (which includes the recognition of a multi-year network rates rebate) and a stronger margin performance in Enterprise. This has been offset by an anticipated decline in National Network Services.

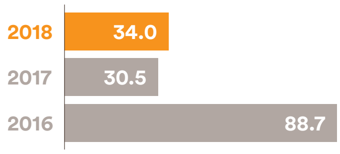
The target for this measure is a performance above market expectation.

This KPI supports the long-term strategy of the Group.

Profit before tax
£ million

£34.0m

+11.5%



This statutory measure reflects the profitability of the business before corporation tax.

Although the Directors believe EBITDA to be the most appropriate measure for rewarding performance and linking to remuneration, profit before tax is an important metric as it is a complete picture of our performance showing all of our income and expenditure, whether capital or operational, alongside exceptional items.

The increase in profit before tax compared to the prior year reflects our EBITDA performance (see separate KPI) alongside a £5.6 million increase in depreciation and amortisation (following our investment in previous years) plus a lower level of exceptional costs due to tighter control in this area. The profit before tax in 2016 includes the £44.0 million profit on disposal of certain national network assets.

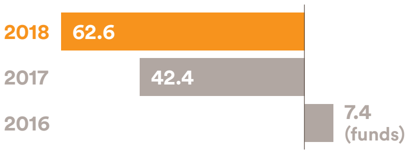
This KPI supports the long-term strategy of the Group.

Link to strategy Customers and Partners | People | Systems and processes | Assets

Net debt
£ million

£62.6m

+47.6%



Net debt is a measure of indebtedness of the business and includes cash and overdraft balances, bank borrowings and amounts owing under finance leases. The level of net debt is important as it shows how much headroom there is with the Group's borrowing facilities and net debt to EBITDA is a key ratio used by external stakeholders. See Note 27 for more details on our loan facility.

The Group has a number of obligations around pensions, capital expenditure and dividends, therefore it is important that we continue to generate cash and manage working capital effectively in order to remain comfortably within our banking facilities (our target). Further detail (including stress tests of a number of scenarios) is shown within our viability statement on pages 33 and 34.

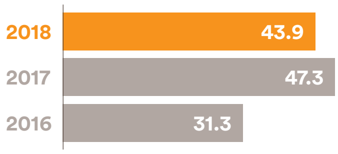
The receipt of proceeds from the sale of certain national network assets in March 2016 resulted in a net funds position. Since then, the Group has re-invested these proceeds in significant strategic investments – largely related to the deployment of fibre in the Hull & East Yorkshire segment - resulting in the net debt position at 31 March 2018. At the same time, the Group has maintained strong management of working capital.

This KPI supports operational or shorter-term objectives of the Group.

Cash capex NEW
£ million

£43.9m

-7.2%



This is a new KPI, Cash capex has always been an important metric but previously it had not been disclosed separately as it is part of the net debt KPI. Given the high current level of investment we believe that this KPI should be disclosed separately.

This reflects the amount of cash that has been paid out of the business in the year on capital expenditure projects. See page 121.

As was the case in the prior year, cash capex this year has been significantly higher than our longer-term levels. This reflects the high levels of capital expenditure in the year associated with the continuation of our fibre deployment programme in the Hull & East Yorkshire area.

It is important that we monitor and control our level of capex in order to manage the impact on the Group's performance (profit before tax) alongside our net debt. We also need to ensure that we invest appropriately in order to generate a strong return on investment and drive business performance. We expect the year ending 31 March 2019 to also have a high level of capital expenditure.

The target for this measure is performance in line with market expectation.

This KPI supports the long-term strategy of the Group.

See more within our APMs on page 121.

Hull & East Yorkshire ARPU NEW
(Average Revenue Per User) £ per month

£35.17

+4.1%

This is a new KPI. ARPU has always been an important metric but previously it has not been disclosed separately as a KPI. We believe this is an important measure for assessing both current and likely future performance in this important growth segment. ARPU is calculated as Hull & East Yorkshire Consumer revenue for the year, divided by the average number of Consumer customers, divided by 12.

ARPU is a key performance measure as it shows the average spend per customer per month in our Hull & East Yorkshire Consumer segment. As the number of customers in this segment is relatively stable, increasing ARPU is the best way to drive growth in the segment.

The increase in ARPU over the past three years has been driven by the increase in the number of consumers taking our higher value fibre products as the fibre deployment has progressed rather than the traditional lower value copper-based products, and by increased broadband penetration levels.

One important consideration in continuing to grow our ARPU is the risk of regulatory changes as set out in our risk section on pages 28 to 34.

We target a year on year increase in ARPU.

This KPI supports the long-term strategy of the Group.

Key performance indicators continued

Link to strategy Customers and Partners | People | Systems and processes | Assets

Non-financial

Hull & East Yorkshire customer satisfaction NEW

Customer satisfaction %

54%

+6%

Customer effort %

61%

+39%

Lightstream net promoter score
Number

-5

Our Hull & East Yorkshire segment has the greatest number of customers and improving customer experience is an important part of our Hull & East Yorkshire strategy.

Customer satisfaction has always been an important measure but not something we have formally reported as a KPI previously. Every 12 months we undertake online and telephone surveys with a representative sample of customers, using a specific set of scoring questions. These scores are collated to create the overall KPIs provided here. We track and report on these key metrics internally and use them to inform the focus of future improvement programmes. We will use these same metrics to communicate progress externally.

The three customer experience measures have all shown progression year on year.

We have invested in a number of aspects of the customer buying journey including a new engineering utilisation and customer communication tool and a better online purchase process. These form part of a longer-term customer experience programme which is underpinned by our investment in IT systems and processes.

These KPIs support the long-term strategy of the Group.

Employee engagement score

We do not have a metric to report this year. In 2018 we introduced a new engagement tool that replaced previous methods of measuring employee engagement. This new arrangement allows for regular measurement and dialogue with colleagues across the Group. As we build a baseline of responses and results we will be able to compare our results against industry benchmarks and set objectives for future improvements. We expect to be able to formalise our plans and targets in the second half of the coming year.

Since January we have had an average response rate of 69 per cent and initial results suggest that we perform well with regard to flexible working, goal setting and manager support.

It is important to understand key drivers of engagement and to be aware of and improve practices or interventions that detract from the engagement experience. Capturing these insights is the first step and will then allow us to set stretching objectives and targets.

This KPI supports operational or shorter-term objectives of the Group.

See also

Performance review
page 18

Sustainability
page 35

DSO (Days' sales outstanding) NEW

30

+11.1%

This is a new KPI. We have always disclosed DSO in our Annual Report and consider it appropriate to show it as a separate KPI this year. DSO is calculated on the countback method based on underlying ledgers.

DSO is a measure of how quickly cash is received after an invoice is raised. Unlike the payment of trade creditors which is largely within our control, managing the receipt of cash from debtors is something that requires significant effort on the part of the business. The varied nature of revenue streams within the Group means that this is an aggregated figure which will not individually apply to each of our market segments.

Our DSO has remained broadly consistent across the last three years demonstrating our ongoing focus on managing our working capital.

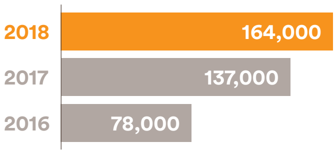
While we do not set a specific quantified target for DSO, and fluctuation does happen during the year as a result of business cycles, we expect year end DSO to be relatively stable year on year, leading to strong working capital management.

This KPI supports operational or shorter-term objectives of the Group.

Hull & East Yorkshire premises passed
Number

164,000

+19.7%



This is the cumulative number of premises in the Hull & East Yorkshire area that have been 'passed' by our fibre deployment and are now able to take services over fibre rather than copper lines.

Fibre rather than copper broadband provides a higher quality of service to our customers and will allow us to transform our underlying network in Hull & East Yorkshire as traditional copper lines and the associated infrastructure can be retired. The increase in the number of premises passed brings us closer to this goal.

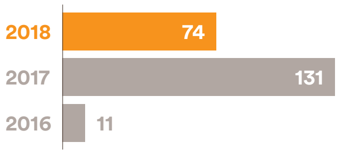
During the year we achieved our December 2017 target of passing 150,000 premises. We are on track to complete our fibre deployment by March 2019.

This KPI supports the long-term strategy of the Group.

Impact of health and safety incidents
Days lost

74

-43.5%



These are the numbers of days' work that have been lost due to health and safety incidents.

There were three reportable incidents during the year (one fewer than last year) which accounted for over 90 per cent of the days lost. All of these were fully investigated and any necessary action taken to avoid reoccurrence.

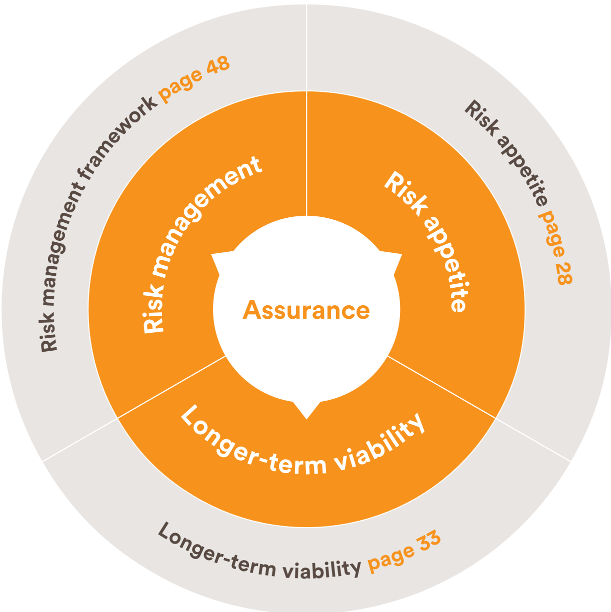
Our target is to have zero days per year lost as a result of Health and Safety incidents.

See risks and reputational damage on pages 28 to 34.

This KPI supports operational or shorter-term objectives of the Group.

Managing risk in our business

Taking the right level of risk



See also

Corporate governance
page 44

As a business we strive to achieve the right balance between risk and reward. We believe that all businesses have to take some level of risk but we want to make sure we do not take unnecessary risks and that we understand and manage the risks that we take. We have set our risk appetite as a business and we consider the risks that we take, both individually and as a whole, in the context of that appetite and the longer-term viability of the business.

The Board and Audit Committee spend time during the year reviewing reports on risks and controls to obtain the assurance they need that our risks are being managed appropriately. This assurance comes from a variety of sources. Further information on our risk management processes is on page 48.

As a result of this review of risks and controls, the Board can confirm that it has carried out a robust assessment of the principal risks facing the business, including those that would threaten the business model, future performance, solvency or liquidity.

Risk appetite

The Board has set the risk appetite for the business and this is regularly reviewed and updated as appropriate. Our risk appetite statement sets out the risk appetite of the business in a number of key areas in relation to commercial risk, customer experience, people, service availability, reputation, health and safety and compliance.

The risk appetite statement continues to show that as a business we are moderate in our risk taking, but we are willing to take greater risk for greater reward in the commercial decisions that we make. We also are risk averse in our approach to our reputation and to health and safety risk and will seek to reduce the inherent risks in these areas through risk avoidance or mitigation.

Brexit

The impact of Brexit is one that we consider regularly and is discussed frequently in relation to the risk or opportunity that it may present to each of our market segments. At the current time we do not consider the impact of Brexit to be one of our principal risks but this is something that we will keep under review.

Risk management

Our principal risks and uncertainties

As with all businesses, we are affected by a number of risks and uncertainties. The tables on pages 29 to 32 shows the principal risks and uncertainties, some of which are beyond our control, that could have a material adverse effect on the business and have been identified through our risk management framework. This list is not exhaustive and there may be risks and uncertainties of which we are currently unaware, or which are believed to be immaterial, that could have an adverse effect on the business.

Link to strategy

Customers and Partners

People

Systems and processes

Assets

Risks reported in the prior year

Growing revenue in our Enterprise segment

Why is it important?
Our Enterprise segment represents our most significant opportunity for growth. Failure to achieve expected levels of growth may impact upon the share price of the business.

What are we doing to mitigate the risk?
We have refreshed a significant proportion of our sales team over the last two years and have also recruited a new Delivery Director and Marketing Director for the Enterprise segment. We have restructured internally to enable an increased level of focus on existing customer relationships to ensure we fully understand the needs and requirements of our customers. We are also investing in new propositions in a number of key focus areas to further enable growth in the segment.

Change in level of risk

The level of risk remains unchanged from the prior year.

How does this link to our strategy?

Substitute technologies entering the consumer market

Why is it important?
Much of our consumer business is currently based on the provision of services over a fixed-line network. If substitute technologies were developed to the extent where similar services could be provided without the use of a fixed-line network then this would present a competitive threat to the consumer part of our business.

What are we doing to mitigate the risk?
We are always seeking to improve our services to our consumers and to provide a speed and quality of service that would not be achievable over a wireless network. Our fibre deployment is part of this aim.

We offer bundles of products and services that offer our customers value for money. We are also investing in innovative products and services which take advantage of the Fibre-to-the-Premises technology that we use in our fibre deployment and which provide a clear alternative to a substitute technology.

Change in level of risk

The level of risk remains unchanged from the prior year.

How does this link to our strategy?

Managing risk in our business continued

Risks reported in the prior year

Upgrading of our network equipment

Why is it important?
The equipment used to run our copper network in Hull & East Yorkshire, and to provide some of our national network-based services, requires regular upgrading as demand for broadband and cloud-based services continues to increase at a fast pace.

What are we doing to mitigate the risk?
We are continuing with our investment plan to mitigate the risk of service failure from obsolete equipment. At the same time we are investing in the continued deployment of our ultrafast fibre-based broadband in Hull & East Yorkshire which provides market-leading broadband speeds and which is on track to be completed by March 2019.

Change in level of risk

The risk is increasing as the equipment nears the end of its life but the mitigation in place means that the net risk has not increased.

How does this link to our strategy?

Accuracy, security and confidentiality of customer data

Why is it important?
The security, confidentiality and accuracy of our customer data is of paramount importance to us and to our customers.

What are we doing to mitigate the risk?
We have clear and comprehensive policies in place and run mandatory training in this area for all employees. We have spent considerable time during the year preparing for the implementation of the General Data Protection Regulation (GDPR), which came into force in May 2018, which has further enhanced our controls around security and confidentiality. We have recruited new roles to focus entirely on data to help ensure our ongoing compliance with GDPR, as well as a separate team focused on the accuracy of customer data in our Hull & East Yorkshire segment.

Change in level of risk

The risk is increasing as the volume and nature of cyber-attacks continues to grow and evolve, which threatens the security of data.

How does this link to our strategy?

Customer service and delivery

Why is it important?
Our aim is to provide exceptional service wherever we can. The risk of not achieving this is therefore a key risk for the business.

What are we doing to mitigate the risk?
During the year we have continued our focus on improving the customer experience in all parts of our business. In our Hull & East Yorkshire segment this has focused around improved training, recruitment and onboarding processes for those working in customer services. Resources have been increased to reduce call waiting times, which has led to increased customer satisfaction. We now ensure we seek feedback from customers more frequently, particularly when they have completed a specific customer journey with us. In addition, our technical support teams have moved into our newly launched Customer Service Operations Centre, a technical centre of excellence which serves our entire business and will help in developing the skills of our technical people further.

Change in level of risk

The level of risk remains the same.

How does this link to our strategy?

Security and resilience of our networks and IT systems

Why is it important?
We need our networks and IT systems to continue operating in order to continue to provide service to our customers. It is therefore essential that we have secure and resilient systems and networks in place.

What are we doing to mitigate the risk?
We hold certifications in a number of standards that relate to security and resilience, including ISO 27001, the Information Security Management standard, and ISO 22301, the Business Continuity Management standard. We have a Head of Security & Compliance who is responsible for ensuring a consistent approach to security and resilience across the business and we have detailed policies and processes in place. We regularly test our resilience plans and feed back any lessons learnt from such tests into the resilience planning process, which in turn is continually reviewed and updated on an ongoing basis.

Change in level of risk
The level of risk remains unchanged from the prior year.

How does this link to our strategy?

Regulatory obligations

Why is it important?
As a telecommunications provider, we are regulated by Ofcom and there are multiple conditions and regulations with which we need to comply. We take our regulatory responsibilities extremely seriously and seek to ensure we are compliant in all regards.

What are we doing to mitigate the risk?
We have an in-house regulatory team which is responsible for ensuring we understand our obligations and that these are communicated to the appropriate people across the business so that we can ensure the necessary controls are in place. We have brought additional resource into this team during the year to enable additional focus in this area. We continue to work closely with our suppliers to make sure that our obligations are passed on and complied with in the areas where we are reliant on third parties for the provision of services.

Change in level of risk
The level of risk remains the same.

How does this link to our strategy?

Health and safety

Why is it important?
The health and safety of our people is of paramount importance to us and we have a number of people who undertake high risk activities; such as climbing telegraph poles, working in confined spaces, working alone or working next to roads. It is important to us to mitigate health and safety risk as far as possible to try to prevent incidents from occurring.

What are we doing to mitigate the risk?
We have an in-house health and safety team with significant experience of health and safety issues specific to our industry. We have a comprehensive training programme in place which provides general training to all of our people, through mandatory e-learning, and specific training to those who undertake higher risk activities, which is then followed up by on-the-job checks to ensure our engineers are practising what they have learnt. For large projects which contain increased health and safety risks, such as our fibre deployment, we have brought in external health and safety advisors to work on the project full-time to ensure we are complying with all of the appropriate health and safety requirements.

Change in level of risk
The level of risk remains the same.

How does this link to our strategy?

Managing risk in our business continued

Risks reported in the prior year

Flooding

Why is it important?
Flooding has become an increasingly regular occurrence in many parts of the country in recent years and Hull, where much of our business is based, is no exception. There were significant floods experienced in Hull in June 2007 and there has been smaller-scale flooding experienced at times since. There is a risk that such flooding could have an impact upon our business if we do not take the necessary steps to mitigate the risk where possible.

What are we doing to mitigate the risk?
Prior to the 2007 floods we had already sought to mitigate the risk of flooding in the design of our telephony network and through using raised floors in some of our buildings. This meant that the impact of the floods in 2007 on our business was minimal. We have continued to improve our defences further since that time, installing pumps at key sites and flood defence barriers where appropriate. We monitor flood risk closely and are always alert to increased risks caused by extreme weather and high tides, so that we can activate our defences as necessary if and when required.

Where we rely on partners to provide services we seek to work with them to ensure that their services are resilient to flooding wherever possible.

Change in level of risk

The level of risk remains the same from the prior year.

How does this link to our strategy?

Risks reported for the first time this year

Ability to attract and retain the key technical skills required in our Enterprise segment

Why is it important?
Many of the services provided by our Enterprise segment are technically complex and require skills that are hard to find and in high demand. Attracting and retaining the right skills is key to being able to deliver the services our customers require.

What are we doing to mitigate the risk?
We have recruited a specialist recruiter in the year solely to focus on recruiting the technical skills we need in our Enterprise segment. We are focused on anticipating the skills we will need in the future as well as those we currently require and we plan our recruitment on that basis. We also have spent time reviewing the packages, incentives and working environment we offer to meet the requirements of those with the skills that we need.

Change in level of risk

The level of risk has increased during the year as demand for certain technical skills has increased across the industry.

How does this link to our strategy?

Contract governance

Why is it important?
Much of our Enterprise revenue is derived from the delivery of complex service contracts, implementing innovative solutions for customers. Appropriate governance is essential to ensure that contract delivery remains within the agreed scope and timeframes and meets the expectations of the customer throughout. During the year we experienced losses on certain software development contracts which highlight the importance of robust contract governance.

What are we doing to mitigate the risk?
A new Delivery Director has been recruited in the year specifically to oversee contract delivery and she has implemented a revised contract governance framework that has brought rigour and clarity to all stages of the contracting and delivery process, with early flags if anything is likely to fall outside of the agreed parameters to enable corrective action to be taken.

Change in level of risk

The importance of this risk to KCOM has increased from last year due to the continued shift towards more complex customer solutions in the Enterprise segment.

How does this link to our strategy?

Viability statement 2018

In accordance with the UK Corporate Governance Code, the Directors have assessed the longer-term viability of the Group, taking into account our business model along with risk appetite and the principal risks affecting the business.

Assessment of prospects

The Group's prospects are primarily assessed through the annual financial planning process which is led by the ELT. The Board participates fully in this process.

The first year of the Group's budget forms KCOM's operating budget which is supplemented by a rolling forecast during the year. Progress against budget and rolling forecast is monitored on a monthly basis by both the ELT and the Board. Mitigating actions are taken when required by trading performance or the rolling forecast process.

The key assumptions behind the Group's financial forecasts include:

> Protecting the Group's Hull & East Yorkshire segment and maximising opportunities presented by our fibre deployment. This segment includes the investment in, and operation of, long life assets;

> Growing the Group's Enterprise segment and maximising growth opportunities. This segment is less mature and opportunities continue to be developed;

> Simplifying the business and reducing the underlying cost base (through transforming the network and streamlining processes and systems); and

> The continued availability of funding beyond the expiry of our banking facilities in December 2021 and the availability of cash flow to maintain the current level of dividend.

The Board considers the Group's strategy and long-term prospects more broadly than the annual budget process. This is particularly relevant given the nature of assets and the investment profile in Hull & East Yorkshire.

The Board remains confident of the long-term prospects of the Group.

Assessment of viability

Although the Group's prospects and planning cycles take into account a longer period, the Directors consider that the period of assessment of viability should continue to be three years. This is deemed appropriate due to predictability of cash flows and in particular the expiry of our current banking facilities. Projections beyond this point become less reliable given contract lengths, the pace of technological change and the level of market and regulatory uncertainty.

Therefore, despite a longer-term assessment of the Group's prospects, the period of viability is limited to a medium-term strategic period of three years.

Scenarios and stress tests

Stress tests have been performed on KCOM's Board-approved budget in order to assess the Group's longer-term viability. We have stress tested our forecast cash flows taking into account severe but plausible scenarios which are aligned to the Group's risk appetite and the principal risks as documented in the Group risk register.

While it is impossible to foresee all risks (or take into account risks which are currently immaterial but could turn out to be significant) mitigation activities could be performed, for example reducing capital expenditure, discretionary spend or making changes to dividend payments. These mitigating actions would only be required in the worst case scenario tested.

Managing risk in our business continued

Scenarios and stress tests continued

Priority	Scenario and why important	Link to principal risk	Viability conclusions
Individual scenarios			
1	**Loss of 20 per cent market share in Hull & East Yorkshire by 2021** > The Group makes the majority of its EBITDA in Hull & East Yorkshire. A loss of market share, due to increased competition or substitute technologies, could create earnings pressure. > This scenario could impact performance.	> Substitute technologies entering the market > Regulatory obligations	> Sufficient headroom exists and net debt: EBITDA covenant not breached over the three year assessment period. > Reverse stress testing shows that covenants are breached in year three if a loss of market share of 27 per cent occurs with no mitigating actions.
2	**Significant security, compliance or regulatory breach in the year ended 31 March 2020** > A security breach or incident could result in reputational damage alongside a significant cash outlay. In this scenario we have assumed costs and a cash settlement. > This scenario could threaten operations and performance.	> Accuracy, security and confidentiality of customer data > Regulatory obligations > Security and resilience of our networks and IT systems	> Sufficient headroom exists and net debt: EBITDA covenant not breached over the three year assessment period.
3	**Material disruption to a key location in the year ended 31 March 2020** > In this scenario we have assumed that a £5.0 million cost is incurred relating to the loss of a key facility. This could also result in reputational damage. > This scenario could threaten operations.	> Security and resilience of our networks and IT systems > Customer service and delivery > Flooding > Health and safety	> Sufficient headroom exists and net debt: EBITDA covenant not breached over the three year assessment period.
4	**Loss of largest customer in the year ended 31 March 2020** > In this scenario we have assumed that our Enterprise segment loses its largest customer. > This scenario could impact performance.	> Growing revenue in Enterprise to offset decline in network-based revenues	> Sufficient headroom exists and net debt: EBITDA covenant not breached over the three year assessment period.
5	**Contractual failure in Enterprise segment in the year ended 31 March 2019** > A contractual failure could result in reputational damage alongside a significant cash outlay. In this scenario we have assumed a cash settlement of £10.0 million. > This scenario could impact performance.	> Growing revenue in Enterprise to offset decline in network-based revenues	> Sufficient headroom exists and net debt: EBITDA covenant not breached over the three year assessment period.
Multiple scenarios			
	All five scenarios occur over three year assessment period > We considered the remote situation where all five scenarios occur over our three year assessment period.	> As above	> Sufficient headroom exists and net debt: EBITDA ratio is not breached in years one and two. In year three, there is insufficient headroom and the net debt: EBITDA ratio is breached unless we take mitigating actions.

The Directors have reviewed and challenged the results of the stress testing and reverse stress testing in forming their conclusions on the Group's longer-term viability.

Viability statement

Based on the results of this review, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three year period ending 31 March 2021.

Operating with a positive effect on our stakeholders and society

Our sustainability strategy covers four main areas that are taken into account when making key business decisions: the communities in which we operate; our people; the relationships we have with our customers and suppliers; and the environment. The Board receives reports on each of these as appropriate. Responsibility for our sustainability strategy sits with our Chief Executive.

Our sustainability strategy is fully integrated and aligned with our business strategy. It is underpinned by three key objectives:

1. To use our expertise in communications technology to create a positive impact on all our stakeholders and the communities in which we operate.
2. To promote our values, both internally and in the way we do business with external stakeholders.
3. To engage and empower our people so they can make a positive contribution to our sustainability strategy and the causes that matter to them.

Community

Our aim is to operate in a way that benefits local communities as well as supporting our strategic business aims. Our significant presence in Hull & East Yorkshire, in terms of both employees and customers, means our business decisions are made with consideration of the potential impact on that community in mind.

Read more
page 36

People

Much of the value we deliver to customers is through the expertise and experience of our people. Our sustainability relies on our ability to attract people with the right skills and behaviours and to motivate, develop, support, recognise and reward them appropriately.

Read more
page 37

Customers and suppliers

Sustainable relationships with customers and suppliers are vital to our success. We have a responsibility to treat them fairly and with the highest ethical standards, and to do business in a way that has a positive effect on them and on society more widely.

Read more
page 38

Environment

We believe all businesses have a responsibility to minimise any negative impact they have on the environment and we make decisions with environmental sustainability in mind.

Read more
pages 39 and 40

Sustainability continued

Community

Achievements in the year

- Our employees spent a total of 2,650 hours volunteering in the community.
- We delivered learning activities in 65 local schools and colleges.
- We provided support to 158 local charity and local interest groups.

Our community relations programme continues to focus on activities that support the growth and sustainability of the Hull & East Yorkshire economy and which increase life opportunities for local residents.

Getting behind Hull 2017

In addition to the support we provided to Hull UK City of Culture 2017 as a Principal Partner, 32 of our people played a part in making the year a success by joining the 2,500-strong army of volunteers who helped visitors find their way around the city, staffed exhibitions at galleries and museums and worked behind the scenes at festivals and outdoor events.

Marketing Manager Rachel Constable was among the KCOM employees who, between them, worked 224 shifts and contributed 647 hours to City of Culture events.

"I decided to become a 2017 volunteer because it was such a huge thing for the city," she says. "I was proud that KCOM was supporting Hull's year in the spotlight and really wanted to do my bit to make it a success. It was a once in a lifetime opportunity – I didn't want to look back afterwards and think 'I wish I'd done that'."

Playing our part in the local business community

We continue to be an active member of business organisations including Humber Bondholders, which promotes the region as a destination for inward investment; For Entrepreneurs Only, a community interest company that helps local entrepreneurs create jobs and wealth; and C4DI (Centre For Digital Innovation), a technology hub that is helping to drive the development of the region's digital sector.

Championing regeneration

Our investment as a Principal Partner of Hull UK City of Culture 2017 helped to unlock the significant boost to the region's economy that the programme delivered. Hull's year as UK City of Culture has been a catalyst for significant physical regeneration in the city and is expected to continue to bring economic, cultural and social benefits in the years ahead.

We are also active members of a number of regeneration bodies including the Humber LEP and City Leadership Group.

Supporting the region's young people

During the year we increased our efforts to encourage the region's young people to consider careers in science, technology, engineering and maths (STEM) through our involvement as an employer sponsor of the Ron Dearing University Technical College (UTC), which opened in September 2017. Our support of the UTC includes the delivery of learning modules and the provision of work experience placements and business mentors for students.

We engaged with a further 64 schools and colleges across the region to deliver STEM learning activities, support employability skills and help to raise aspirations and achievement levels.

Charity and community support

During the year we supported 158 community groups and charities in Hull & East Yorkshire by donating funds, employee time and business services. Our employees spent 2,003 hours volunteering by supporting charity collections, delivering educational activities in schools and helping local residents learn internet skills.

Beyond Hull & East Yorkshire, we continued our support of Teenage Cancer Trust, which provides care to young people in the UK who are affected by cancer. In the final year of our partnership our employees raised more than £15,000 for the charity, taking the total raised over three years to more than £177,000.

We have also continued our patronage of The Prince's Trust, the UK's leading youth charity, which changes young lives by offering training, personal development, business start-up support, advice and mentoring.

People

Achievements in the year

- We have established a Company-wide, flexible, skilled-based resource pool.
- We have improved significantly the way we manage the contract resources we employ to support delivery of customer projects in our Enterprise segment.
- We have insourced engineering services previously provided by a third party to allow us to deliver the services more effectively.

A key focus during the year has been on ensuring we have the right technology skills within our Enterprise segment to deliver complex customer projects. In addition to investing in and fostering learning and development among our people through our professional communities, we have engaged a strategic partner for the management of flexible contract resources to supplement our capability and fill short-term skills gaps. This partnership gives us access not just to a wide talent pool, but also to valuable market intelligence to inform our people strategy.

We review our people strategy on an ongoing basis to ensure it is appropriate to support our business strategy. Changes in our business in recent years, and in particular the ongoing investment we are making in network transformation and the technologies we use and deliver, led us at the end of the year to bring in-house some engineering services that had previously been carried out on our behalf by BT. As well as allowing us to deliver the services in a more flexible and efficient way the move means we are better able to differentiate ourselves on the basis of customer experience.

Improvements in longer term workforce planning are enabling us to see further ahead in terms of demand for key skills and capabilities to deliver solutions to our customers and continue to develop our strategic propositions. As a result we have been able to increase our recruitment of graduate and apprentice talent, providing them with clear development plans to fulfil future capability needs. Most recently, we have engaged a number of graduates in technical functions within our Enterprise segment.

Encouraging employee health and wellbeing

Education is a key part of our approach to employee wellbeing. Our 'health and wellbeing' programme provides information and self-help tools to support physical and mental health and wellbeing.

As in previous years, we offered free, confidential health screening sessions where employees could have their Body Mass Index, cholesterol and glucose levels and blood pressure checked by an independent third party to help identify potential health issues.

A total of 411 employees attended sessions held at our eight main sites. A survey of attendees indicated that those who took part rated the service very highly, giving it an average score of 9.42 out of 10 for its overall value.

Feedback from participants included this comment: "This is an excellent health and wellbeing service. It is a great opportunity to assess and take responsibility for your own health, making lifestyle changes as and when required with the aim of avoiding future health problems."

We have also utilised the government's apprenticeship levy to employ new apprentices who will undertake development programmes within our engineering, finance, compliance and client services functions.

Employee engagement is a key factor in motivating and retaining people. Towards the end of the year we introduced a new employee engagement tool that gives people managers timely feedback and insight into how they can support their teams to perform at their best.

We have had an Employee Forum in place for some time which meets regularly to discuss organisational change and provides an opportunity for colleagues to give feedback on change programmes. We have recently expanded this team and have additional plans for engaging it further in the coming year.

Gender diversity and pay

We have clear policies in place which mean that men and women are given equal opportunities, throughout their careers with us. As at the year end the gender diversity of the Group was as set out in the table below:

	Male	Female	Female %
Board Directors	4	2	33%
Executive Leadership Team (ELT)[1]	5	3	38%
Other employees	970	480	33%

1. The ELT is defined as the senior leaders who have overall responsibility for key functional areas. It includes Executive Board Directors Bill Halbert and Jane Aikman.

Our first gender pay gap report, based on the snapshot date of 5 April 2017, showed a mean pay gap of 29 per cent and a median pay gap of 38.1 per cent, highlighting that there remains work to do to bring greater balance to our business.

While there are a range of factors that can affect gender pay equality, it is in part driven by the ratio of male to female employees within traditionally male-dominated technical and engineering functions. The ability to recruit from a larger, more diverse employment pool is clearly important for our business and we are placing significant focus on encouraging more diverse participation in these career streams. We are taking some longer-term actions as part of our engagement within the schools and colleges of our community, principally focused on encouraging participation in STEM subjects.

As well as addressing barriers to participation, we are committed to inspiring greater levels of female leadership by encouraging women to move through the various leadership levels of our business, supporting them where necessary to realise their potential and removing any obstacles that may exist.

This activity is being led by members of the ELT including Sean Royce, who has leadership responsibility for our Technology, Service and Operations functions.

Human rights

We respect fundamental human rights consistent with the United Nations Universal Declaration of Human Rights and we ensure that all of our internal policies are consistent with this. We do not have any current human rights issues.

Customers and suppliers

Achievements in the year

- We became a supporter of Internet Matters, a not-for-profit organisation dedicated to promoting online safety.

Relationships with customers

We believe we have a responsibility to our customers to tackle issues that are important to them in relation to the products and services they buy from us.

In our Hull & East Yorkshire market we have continued to strive to address the barriers to digital inclusion faced by many in the community. During the year we carried out a significant review of our portfolio of broadband packages to introduce greater flexibility and more price points so that customers are better able to choose a service that meets their needs and budget.

In addition to hosting our own regular internet drop-in sessions, where customers can develop their online skills in a relaxed environment, we worked with local authorities to facilitate similar events in local libraries and community centres.

Through our support of Internet Matters we now have access to tools and guidance that have boosted our ability to raise awareness of e-safety issues affecting children and young people.

At the start of the year we improved our Social Access Package (SAP), a phone service for low-income households in Hull & East Yorkshire, by introducing a price cap. The price cap removes the worry of unexpected bills for our most vulnerable customers by ensuring that they will not be charged more than £10 per month in total for any calls made outside of those included in the package.

Relationships with suppliers

As well as treating our suppliers fairly and doing business with them in a sustainable way, we also have a responsibility to make sure that our suppliers also operate with high ethical standards.

We expect suppliers to sign up to our Supplier and Partner Code of Conduct and we work closely with key suppliers to ensure we understand their approach to sustainability and the way in which their business operates.

Contracts with key partners and suppliers include provisions relating to mitigation of risks that may affect their ability to provide us with goods and services, and we carry out regular credit checks on all suppliers.

In addition, our business continuity planning activities place significant focus on ensuring that in the event that key suppliers are affected by a business disruption we are able to continue supplying services to our customers. We test our business continuity plans regularly to ensure continuous improvement.

Helping to keep children safe online

The internet is one of the greatest innovations of our time, offering children endless opportunities to learn, create and communicate. But with these possibilities comes the challenge of ensuring they stay safe when they are online.

During the year KCOM became a supporter of Internet Matters, a not-for-profit organisation that helps parents keep their children safe in the digital world.

Backed by the UK's biggest broadband providers and supported by leading online child safety experts, it offers information on tackling e-safety issues and advice to help parents take practical and simple actions to help children enjoy the internet safely, whatever their age.

As a supporter of Internet Matters we are now better able to raise awareness of online risks among children and to signpost their parents towards the best guidance to reduce these risks.

We are also members of the Internet Watch Foundation, an international organisation focused on making the internet a safer place.

Environment

Our biggest environmental impact comes from the electricity we use in our offices, data centres and various network sites, both nationally and in the Hull & East Yorkshire region. During the year 81.0 per cent of our CO_2e emissions came from our electricity usage.

Each year we seek to reduce our emissions wherever possible through various energy-saving schemes and we continually review and improve the recycling facilities we have in place at our offices, with the aim of making it as easy as possible for our people to recycle any waste we produce.

Achievements in the year

> Over 94 per cent of our waste has been recycled, with the actual tonnage of waste that has gone to landfill falling slightly from 17.9 tonnes to 17.5 tonnes. During the year we changed our waste management supplier and as a consequence much more of our waste is now recycled as Refuse Derived Fuel (RDF) which should significantly reduce the amount of our waste going to landfill in future years.

> In the year the CO_2e tonnes produced from our electricity usage has fallen by 2,378 tonnes or 16.0 per cent. This reflects a two per cent reduction in the number of kilowatt hours of electricity used and a lower carbon factor published by the Department for Business, Energy and Industrial Strategy, which are the factors we use each year to calculate the conversion of our electricity usage and other carbon emissions into CO_2e tonnes.

Breakdown of our emissions %

Premises – electricity	81.0%
Premises – other fuel and waste	9.7%
Business travel	9.3%

Emissions in the year

The table below sets out our annual emissions in tonnes of CO_2e.

	Year ended 31 March 2018 CO_2e	Year ended 31 March 2017 CO_2e[1]
Combustion of fuel and operation of facilities	**2,934**	3,211
Purchase of electricity	**12,520**	14,898
Total	**15,454**	18,109
Tonnes of CO_2e per £'000 of revenue	**0.051**	0.055

1. The 2017 figure has been restated to include overnight hotel stays, for which carbon factors have been published for the first time this year by the Department for Business, Energy and Industrial Strategy. We have restated the 2017 figures assuming the same carbon factors for both years which has meant an increase in the 2017 figure of 235 tonnes of CO_2e.

Reducing our energy consumption

During the year we have continued to seek opportunities to reduce our electricity usage.

Having already reduced the energy required for lighting last year by replacing fluorescent lighting with LED lighting in our main offices, we are now installing it at smaller sites on a tactical basis when other work is taking place at these sites.

We have also continued our deployment of PIR (passive infrared) motion sensors at technical sites, where visitors are infrequent, to further reduce lighting costs.

We continually review our generator assets to ensure we are able to maintain business continuity by securing our power supply during energy disruptions and are exploring the potential to assist in managing energy capacity in the UK by investing in networked generator controllers that will allow us to come off the National Grid during periods of peak demand. We intend to conduct a pilot to test the feasibility of this in the coming year.

As part of the transformation of our Hull & East Yorkshire network, we will also seek in the year ahead to introduce more efficient DC power systems in more than half of our exchanges.

Environment continued

Emissions in the year continued

Our carbon emissions from combustion of fuel and operation of facilities has fallen in the year by 8.6 per cent. This decrease is due entirely to a reduction in carbon emissions arising from less business travel in the year. This has arisen due to the continued encouragement of our employees to travel only when necessary, and to make full use of the online means of communication that we have in place. We acknowledge, however, that some travel is essential in order to do business and it is important that we are able to meet face-to-face with our customers whenever necessary.

Information for our carbon emissions reporting comes from our own internal systems, third party travel companies, suppliers of fuel, waste collection and recycling services and from our electricity supplier.

Area	Actual	Target for the year under review	Target met?	Future target for 2018/19
Total CO_2e	15,454 tonnes	Not to exceed 2016/17 levels of 18,109 tonnes.[2]	✓	Not to exceed 2017/18 levels of 15,454 tonnes.
Waste sent to landfill	17.5 tonnes	To return to 2015/16 levels of 17.4 tonnes or less.	✗	No target has been set for 2018/19[1].
Energy efficiency in transport	1,432 tonnes	No target was set for 2017/18.	N/A	Not to exceed 2017/18 business travel energy consumption levels of 1,432 tonnes.

1. No target has been set for 2018/19 for waste sent to landfill as our change of waste management supplier in the year means that in 2018/19 none of the waste produced at KCOM-managed sites will go to landfill. An alternative target has been set instead.
2. The target for the year has been restated to include overnight stays, to ensure we are comparing like with like.

Non-financial information statement

In order to comply with the requirements of the Companies Act Sections 414CA and CB, we have disclosed the following information in the places referenced below:

> Information on environmental matters is shown in our Sustainability report on pages 39 and 40.
> Information on our employees is also shown in our Sustainability report on page 37 and as part of Other disclosures on page 56.
> Information on social matters is shown in the community section of our Sustainability report on page 36.
> Our respect for human rights is set out in the People section on page 37.
> Our approach to anti-corruption and anti-bribery matters is set out in Other disclosures on page 56.
> Our business model is described on pages 10 and 11.
> Our principal risks, and how we manage them, are described on pages 29 to 32.
> Other non-financial key performance indicators are shown on pages 26 and 27.

Signed by order of the Board

Kathy Smith
Company Secretary
8 June 2018

Directors' report

Board of Directors

Graham Holden
Non-Executive Chairman

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Appointed Graham joined the Board as a Non-Executive Director in November 2007 and became our Non-Executive Chairman on 1 April 2014.

Skills and experience Graham was Group Chief Executive of Marshalls plc from 2004 until 2013 and before that was a divisional CEO between 2000 and 2004. Prior to that he was Group Financial Director from 1992 to 2000. This means that Graham brings significant experience to the Board of leading a listed business of a similar size to KCOM. Based in Yorkshire, Graham understands the regional market in which KCOM operates in Hull & East Yorkshire and, as a Chartered Accountant, Graham brings considerable financial knowledge and expertise to the Board.

Other roles Graham is a Visiting Fellow in the School of Management at Cranfield University.

Bill Halbert
Chief Executive

Appointed Bill joined the Board as a Non-Executive Director in September 2006 before stepping up to become Executive Chairman in July 2009. Bill was then appointed as Chief Executive on 1 April 2014. On 22 February 2018 it was announced that the Board had started the process to recruit a new Chief Executive, in order to effect a managed succession plan for the leadership of the business.

Skills and experience Bill brings a huge amount of industry knowledge and expertise to the Board, having worked in the information technology sector for over 40 years. Prior to KCOM, he founded Syntegra, BT's global consultancy and systems integration subsidiary, and was the CEO there for 13 years. Bill has also had many years of experience of working on a PLC Board and operating in a regulated environment.

Other roles Bill holds directorships at Excelsys Ltd and Tacit Connexions Ltd.

Jane Aikman
Chief Financial Officer

Appointed Jane joined the Board in 17 October 2016. On 17 May 2018 we announced that Jane would step down from the Board on 30 June 2018.

Skills and experience Jane has held a number of executive level positions in various companies. Jane was Chief Financial Officer and Chief Operating Officer for Phoenix IT Group Plc, which she held until its acquisition by Daisy Group. Prior to that she was Chief Financial Officer of Infinis plc, Wilson Bowden plc and Pressac plc. She also spent five years in Southeast Asia with Asia Pulp and Paper Co Limited. Jane is a member of the Institute of Chartered Accountants in England and Wales and has brought a wealth of financial and operational leadership experience to the Board, as well as sector-specific expertise through her time spent with Phoenix IT Group Plc.

Other roles Jane is a non-executive director of Morgan Advanced Materials plc.

Peter Smith
Non-Executive Director

A R N

Appointed Peter joined the Board in January 2015.

Skills and experience Peter has worked for L.E.K. Consulting LLP for 30 years and brings to the Board a broad range of experience in assisting companies across a range of sectors in setting their strategic plans and optimising their performance. Prior to joining L.E.K., Peter worked for Schlumberger Wireline in the Middle East as a field engineer and a line manager.

Other roles Peter works full-time at L.E.K. Consulting LLP.

Patrick De Smedt
Senior Independent Non-Executive Director

A R N

Appointed Patrick joined the Board in January 2016.

Skills and experience Patrick has a wealth of experience in the technology sector, having held a number of senior positions in Microsoft between 1983 and 2006, during which he founded the Benelux subsidiaries, led the development of the Western European business and served as Chairman of Microsoft for Europe, the Middle East and Africa. He brings experience of leadership and strategy-setting in the sector and has also undertaken a range of non-executive roles with a number of different organisations, which has given him significant experience of PLC boards.

Other roles Patrick is the Senior Independent Director at Morgan Sindall Group plc and Pagegroup plc and Chairman of GCI Limited.

Liz Barber
Non-Executive Director

A R N

Appointed Liz joined the Board in April 2015.

Skills and experience Liz brings a breadth of financial experience to the Board, having previously been a Partner at Ernst & Young from 2001 and their Head of Audit for the North of England from 2006 to 2010. She joined Kelda Group in 2010 as Group Director of Finance, Regulation and Markets and therefore brings knowledge of operating in both a regulatory environment and the Yorkshire region. She is a Fellow of the Institute of Chartered Accountants in England and Wales.

Other roles As well as her full-time role at Kelda Group, Liz is a Non-Executive member of the Board Council for Leeds University, a member of the Prince of Wales Accounting for Sustainability Group and a Steering Group member of the Two Percent Club, which seeks to support balanced board memberships.

Kathy Smith
Company Secretary

Appointed Kathy took on the role of Company Secretary in July 2010.

Skills and experience Kathy is a Fellow of the Institute of Chartered Accountants in England and Wales, qualifying with Deloitte. She joined KCOM in September 2005 as Head of Internal Audit and now leads our risk and governance teams, alongside her Company Secretary role. She is an Associate member of the Chartered Institute of Secretaries and Administrators.

(A) Audit
(R) Remuneration
(N) Nomination
Committee Chairman

Directors' experience/backgrounds

- Finance **3**
- Strategy **4**
- Sector specific **3**
- PLC Board **5**
- Regulatory **2**

Board composition

- Chairman **1 / 16.7%**
- Independent Non-Executive Directors **3 / 50.0%**
- Executive Directors **2 / 33.3%**

Corporate governance

Board length of service

Director	Appointment	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Graham Holden (Chairman)	27 November 2007												
Jane Aikman	17 October 2016												
Liz Barber	7 April 2015												
Patrick De Smedt	28 January 2016												
Bill Halbert	1 September 2006												
Peter Smith	5 January 2015												

Appointment and replacement of Directors

It is the policy of the Board that all Directors wishing to continue in office will stand for election or re-election each year at the AGM.

The Articles of Association allow the Board to appoint a new Director at any time; however, the Articles state that the new Director will only hold office until the next AGM, at which point he or she must stand for election or vacate the office.

The Nomination Committee, and the Board as a whole, has reviewed the performance and contribution of Graham Holden, Liz Barber, Patrick De Smedt and Peter Smith, and has no hesitation in proposing the re-appointment of each of these Board members. We announced on 22 February 2018 that a process had begun to find a successor for Bill Halbert, our Chief Executive. That process is underway, however, in the meantime Bill continues to provide valuable leadership in the business and will stay to ensure an orderly handover. We therefore believe that it is for the good of the business that Bill also stands for re-appointment at the AGM. We believe we have a diverse and balanced Board with a combination of skills that meets the current needs of the business and therefore all of these Directors are recommended for re-election on the basis of their contribution.

On 17 May 2018 we announced that our Chief Financial Officer, Jane Aikman, had decided to leave the business on 30 June 2018 and therefore Jane will not be standing for re-election at the AGM. On 4 June 2018 we announced that Anna Bielby was being promoted internally to the role of interim Chief Financial Officer, with effect from 1 July 2018, and therefore Anna will stand for election at the AGM. Anna is a Fellow of the Institute of Chartered Accountants in England and Wales and has worked in our Finance department for over four years, running our Group Finance Services function. The Board believes that Anna has the right skills and experience to bring considerable value to the role of Chief Financial Officer.

The Articles of Association state that the Company may remove a Director by ordinary resolution with special notice before the expiration of their period of office. There have been no Directors removed from office during the year.

Independence

The Board reviews the independence of the Non-Executive Directors each year, taking into account their tenure, relationships and circumstances as well as considering the behaviour of each Director at Board meetings and whether or not they contribute to unbiased and independent debate. All of the Non-Executive Directors and the Non-Executive Chairman were independent upon appointment and the Board believes that all three Non-Executive Directors remain wholly independent in relation to the criteria set out in Provision B.1.1 of the UK Corporate Governance Code.

Our Non-Executive Chairman, Graham Holden, has been with the business since November 2007. At the time of his appointment as Chairman, he had been with the business for seven years as a Non-Executive Director and was therefore independent upon appointment, which complies with the requirements of the UK Corporate Governance Code. There has been considerable change on the Board in recent years and Graham has provided stability and continuity throughout that period, which we believe has been beneficial to the business. Therefore, despite the length of his tenure, the Board believes that it is in the best interests of the business for Graham to continue in his role to provide the leadership and continuity that the business needs at this time.

Commitments of the Non-Executive Chairman

Graham does not currently have any other significant commitments.

UK Corporate Governance Code

The Board considers that it has complied with all the detailed provisions of the UK Corporate Governance Code throughout the year ended 31 March 2018.

It has done this through various means described in this report, which include setting out clear responsibilities, ensuring its effectiveness is regularly reviewed, having regular interaction with shareholders and spending time to make sure the Board understands its accountability.

The Board as a whole is committed entirely to the principle of achieving and maintaining a high standard of corporate governance.

The UK Corporate Governance Code is available on the Financial Reporting Council's website at www.frc.org.uk.

Board Committees

The Board has established and delegated specific responsibilities to Audit, Nomination and Remuneration Committees. Each Committee reports back to the Board after each meeting to ensure that the whole Board is aware of the matters considered by the Committees.

Each Committee has its own report which sets out the membership and attendance at the Committee meetings during the year, as well as further information on the role of the Committee. The Audit Committee report can be found on page 52, the Nomination Committee report on page 49 and the Remuneration report on page 58.

How the Board operates

The Board has eight scheduled meetings a year, with other ad hoc meetings held as needed. During the year, the Board met 11 times. The additional meetings were to consider the outcome of a report from Ofcom and to discuss the recommendations of the Nomination Committee in relation to the succession of the Chief Executive. Attendance at the meetings during the year is shown in the table on page 45. Seven of the meetings were preceded the evening before by an informal meeting over dinner, allowing more time to debate issues in depth.

The Board agenda is set for each meeting by the Chairman with input from the Executive Directors and the Company Secretary. In addition, any of the Non-Executive Directors can request a matter to be added to the agenda at any time. At each meeting the Board considers business performance, which includes reviewing past performance but also looking at the future long-term success of the business. There is considerable focus at each meeting on the strategy of the business and updates on the progress in each of the key strategic areas are provided at each meeting, which form the basis for discussion and debate around all aspects of strategy.

The Board receives monthly reports on financial performance, people matters, investor relations, governance, compliance and health and safety, regardless of whether or not a Board meeting is scheduled. There are also regular updates on risk registers, key projects and strategic programmes and the Board has received regular updates in the year on our GDPR compliance progress. The Board also hears from external experts when it is believed useful to do so.

Board meetings are held at various KCOM offices throughout the year and the Board seeks to regularly meet both formally and informally with senior management from across the business to gain further insight into the day-to-day operations and the key risks and opportunities facing each part of the business.

Members of the ELT and other key senior managers are regularly invited to attend the Board dinner or Board meetings to provide updates and give the Non-Executive Board members regular direct access to the management team.

There is a schedule of Matters Reserved for the Board which is reviewed and updated on a regular basis. This schedule requires that specific matters relating to budgets, strategy, performance against objectives, financial reporting, internal controls, communications, remuneration and governance, along with any proposed changes to business operations or the structure and capital of the Company, are referred to the Board for consideration and approval.

The Board also reviews contractual clauses escalated to the Board through our Contract Risk framework and business cases escalated in accordance with our business-wide delegations of authority.

The Board considers the role of the Company Secretary to be key in ensuring that the Group and the Board have the right governance in place and that Board processes follow best practice. The Company Secretary meets with each of the Directors individually as necessary to discuss governance-related matters and provides a governance report to the Board on a monthly basis. The Directors are also able to obtain independent professional advice at the Group's expense whenever necessary.

Attendance at Board meetings

Director	Number of meetings	Out of possible
Graham Holden (Chairman)	11	11
Jane Aikman	11	11
Liz Barber	11	11
Patrick De Smedt	11	11
Bill Halbert	10	11
Peter Smith	10	11

Bill Halbert and Peter Smith were both unable to attend one of the additional Board meetings held during the year, due to prior commitments. The Chairman spoke to both Directors prior to the meeting to obtain their input and this was then relayed as part of the discussion in the meeting itself.

Training and development

The Board receives monthly updates on governance-related matters and more formal training where appropriate. Potential training needs are discussed as part of individual performance evaluations, plus each Director is given the opportunity to flag any additional training requirements which they may have identified as part of the annual Board evaluation process.

New Directors joining the Group are given a broad and comprehensive induction to the business, consisting of site visits, meetings with key personnel and detailed information relating to each market segment and the Group as a whole, as well as any training specifically required in relation to the duties of Directors and their role on the Board.

Relations with shareholders

It is essential that we communicate effectively with our shareholders and understand their views. Our Chief Executive and Chief Financial Officer meet regularly with our institutional shareholders to discuss the strategy, performance and governance of the Company and to obtain feedback. During the year, meetings have been held with 41 such shareholders. There are also general presentations following the half year and final results announcements each year and we held a Capital Markets Day in February 2018 where we provided a detailed overview of the go-to-market strategy for each of our three market segments and the investment we are making in our core assets and capabilities.

The Chairman ensures that an investor relations report setting out any feedback from shareholders is provided to the Board each month and discussed at each Board meeting, so that all of our Directors are kept informed of investor views.

Any member of our Board, including our Senior Independent Director, is available to meet with our institutional shareholders if requested to do so and three such meetings have been held during the year.

We have a large number of shareholders who live in the Hull & East Yorkshire region and the KCOM business is very much involved in local life in the area. There is more information about our community activities in the Sustainability section on page 36. We believe that being involved in the local community in Hull & East Yorkshire helps us to better understand our local shareholders and the issues that are important to them.

We consider our AGM to be an important means of communication between our shareholders and Directors. All of our Directors, with the exception of Jane Aikman, who will leave the business on 30 June 2018, will be available at the AGM to answer questions and we would encourage our shareholders to come along to speak with them.

We use electronic voting at our AGM each year. The results of voting, including the proxy votes lodged, are shown to shareholders in the meeting and are made available after the meeting on our website.

All of our company announcements are published on our website, www.kcomplc.com, together with presentation materials and financial reports, so that all of our shareholders can keep up to date with our news.

Corporate governance continued

Business model and key performance indicators

The details of our business model can be found on pages 10 and 11 and our key performance indicators are on pages 24 to 27.

Proposal to re-appoint the external auditors

PricewaterhouseCoopers LLP have advised of their willingness to continue in office and have confirmed their continued independence. Following consideration of the relationship with the external auditors, as described on page 52, the Audit Committee has recommended to the Board that PricewaterhouseCoopers LLP are re-appointed and a resolution to re-appoint them will be proposed at the AGM. They have provided an independent audit opinion on these accounts which can be found on page 76.

Performance evaluation

In the summer of 2017 our annual Board evaluation was externally facilitated by Independent Audit Limited, using an online self-assessment service. The review highlighted that key strengths of the Board include the Board culture and the dynamics of how the Board works.

Two key areas for focus arose from the review. These were:

- The need for greater clarity in the communication of our business strategy. The Capital Markets Day, held in February 2018, sought to address this with much greater clarity being presented to our shareholders and potential investors in relation to the go-to-market strategy for each of our market segments.
- The desire for greater visibility at Board level in relation to detailed progress against strategic objectives. There has been considerable work put into this during the year with a broader range of senior managers being given the opportunity to speak directly with the Board and a new range of KPIs being reported on a monthly basis to provide more detail of progress against objectives, as well as new standing agenda items which provide regular updates on strategic matters.

Our annual Board evaluation in the prior year was conducted by our Company Secretary, Kathy Smith, through one-on-one meetings with each Board member. The objectives arising from this review were included in our Annual Report last year. An update on the progress against these objectives is shown in the table below.

Objective from prior year evaluation	Progress in the year to 31 March 2018
> Have visibility of an increased volume of non-financial data to enhance the Board understanding of operational matters and to enable continued consideration of a broad range of stakeholders in Board discussions.	The Board reporting in the year has been enhanced to include an increased amount of non-financial data, including a revised set of KPIs which are now reported against each month.
> Focus on succession planning for the senior management team, with reference to current skills in comparison to future skills requirements, as well as continuing the discussion in relation to Board succession.	A number of discussions around succession planning have taken place with both the Board and the Nomination Committee. The Board has met frequently with members of the senior management team during the year and a number of changes within the senior management team have brought discussions around succession planning to the fore.
> Invite a thought leader from the IT services sector to speak openly with the Board regarding the future of the sector, to enable a full debate around the future strategy of the business.	A thought leader from the IT services sector presented to the Board earlier in the year to talk about the sector and to enable a detailed discussion about the future strategy of the business. In addition, sector experts continue to be engaged in relation to specific pieces of work in both the Hull & East Yorkshire and Enterprise market segments.
> Continue the increased contact time and frequency between the Board and the senior management team, to enable detailed understanding of relevant operational and strategic matters.	Members of the senior management team have continued to be invited to attend both the Board meetings and the informal Board dinners, to give the opportunity for more detailed discussions and the building of stronger relationships between the Board and the wider senior management team.
> Continue to ensure a full debate in the boardroom with input encouraged from all Board members, to safeguard this as a key strength of the Board.	There has been regular, robust debate in the boardroom at each of the Board meetings this year, with the Chairman ensuring that all views are heard and that sufficient time is given to enable full discussions of the key topics.

In addition to the annual Board evaluation, the Non-Executive Chairman meets with each Board member individually on at least an annual basis to discuss their own performance and to identify any areas for development or potential training needs. The Non-Executive Directors also meet separately to evaluate the performance of the Non-Executive Chairman. The feedback from this meeting is then passed on by the Senior Independent Director.

Non-Executive Director meetings

The Non-Executive Directors have regular dialogue with each other concerning Board matters and the Non-Executive Chairman met with the Non-Executive Directors, without the other Directors present, at regular intervals during the year.

Powers of the Directors

The business of the Company is managed by the Directors, who may exercise all the powers of the Company, subject to the provisions of the Articles of Association, relevant statutes and any special resolution of the Company.

The Articles of Association give the Directors the power to authorise conflicts of interest in relation to transactions or arrangements with the Company, in accordance with the Companies Act 2006. Conflicts of interest are a standing agenda item at Board meetings and each Director proposes any potential conflicts for consideration as soon as they become aware of them.

Substantial shareholdings

As at 31 March 2018, the Company had been notified of the following interests amounting to three per cent or more of the voting rights in the issued ordinary share capital of the Company.

	Number of shares with voting rights	% of total voting rights
Invesco Asset Management	53,744,816	10.40
Teleios Capital Partners GmbH	44,023,371	8.52
PrimeStone Capital LLP	26,535,329	5.14
M&G Investment Management Ltd	23,088,918	4.47
Aviva Investors	21,261,185	4.12
Majedie Asset Management Ltd	20,918,255	4.05
Aberforth Partners LLP	17,752,495	3.44
Fidelity Worldwide Investment	16,373,197	3.17

As at 8 June 2018, there had been no additional disclosures received.

The Director with the potential conflict is excluded from the vote to authorise the transaction or arrangement.

Any conflicts that are authorised are then logged on a register, along with details of any specific terms imposed upon authorisation. Internal controls are in place to ensure that transactions or arrangements which may lead to a potential conflict of interest are conducted on an arm's length basis.

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). 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 these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the EU have been followed, subject to any material departures disclosed and explained in the financial statements; and
- 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 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 and, as regards the Group financial statements, Article 4 of the IAS Regulation. The Directors 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 Group's website, www.kcomplc.com. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' statement pursuant to the Disclosure and Transparency Rules

Each of the Directors as at 31 March 2018 whose names and functions are listed on pages 42 and 43 confirm that, to the best of their knowledge:

- Group and the Company financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Company respectively; and
- the Strategic report and Directors' report contained in the Annual Report include a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that they face.

Conclusion on the Annual Report

The Board is responsible for reviewing the Annual Report and, after consideration, has concluded that the Annual Report, taken as a whole, is fair, balanced and understandable and that it provides the necessary information for shareholders to assess the Group's position, performance, business model and strategy. In reaching this conclusion, the Board has considered the different types of shareholders that the Group has, the reports and presentations that the Board has received during the year and the reports submitted to the Audit Committee during the year by both the internal and external auditors and combined this with the Board's collective knowledge of the business, gained through both formal and informal meetings and personal interactions across the Group at all levels. Further information on the reports submitted to the Audit Committee can be found in the Audit Committee report on pages 52 to 55.

Amendments to the Company's Articles of Association

Any amendments to the Company's Articles of Association may be made by passing a special resolution at a general meeting of the shareholders.

Corporate governance continued

Going concern

The Directors confirm that, having reviewed the Group's budget and forecasts along with the principal risks and uncertainties facing the Group, they are satisfied that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the Group continues to adopt the going concern basis in preparing the financial statements.

Our risk management framework

For us, risk management is about taking the right amount of risk to support our business strategy and to align with our risk appetite. Further information on our risk appetite can be found on page 28.

We seek to understand our risks so that informed decisions can be taken from a risk perspective and so that risks can be either managed or mitigated as appropriate. We have controls in place to mitigate risk to an appropriate level but we recognise that our internal control systems can provide only reasonable and not absolute assurance against material misstatement or loss.

We have a risk management framework in place to help us to identify, assess, measure, manage and monitor our key risks in a consistent way. We define key risks to be anything that may prevent us from meeting our objectives. The framework is aligned with guidance from the Financial Reporting Council to provide us with a single picture of the threats and uncertainties we face.

Our risk management framework

Risks identified

- By our people
- Through the whistleblowing process
- Through our formal risk assessment processes
- From internal or external audits

Reported on Risk Portal

- Assessment of controls that impact upon the risk
- Assigned an owner
- Assessed for probability and impact
  Categories for ratings include customer impact, people, reputation, financial, compliance, service availability and health and safety
- Acceptable level of risk proposed
  Clear plans to fill any gap between the current position and the acceptable position

Reviewed regularly by the ELT and the Board

- Considered in relation to the overall risk profile of the business and in comparison to the risk appetite of the business
- The assurance required in relation to the controls in place is set by the Board – this may be through independent internal audits, management reports or regular reporting of key risk indicators

Continual monitoring and updating

The risks that are identified and recorded by the framework are reviewed regularly by the ELT and then escalated twice-yearly to the Board.

The framework has been in place throughout the year under review, and up to the date of approval of this Annual Report.

Risk management responsibilities

The Board

The Board has overall responsibility for setting the risk appetite for the business and for ensuring that the overall risk profile is aligned with this. It is also responsible for ensuring that the business maintains sound internal control and risk management systems, as well as reviewing the effectiveness of those systems.

In order to do this, the Board has regular meetings with members of senior management and receives regular reports from each business area, the internal auditors and the external auditors on the effectiveness of the systems of internal control and risk management. The Board is satisfied that the systems are embedded within the day-to-day activities of the business and cover all material controls, including financial, operational and compliance controls, and that the business continues to be compliant with the provisions of the UK Corporate Governance Code relating to internal control.

Executive Leadership Team

The ELT is responsible for reviewing the risks that have been recorded, to ensure completeness and accuracy, as well as assessing the suitability of the mitigations in place and any proposed timescales for further controls to be implemented.

Audit Committee

The responsibilities of the Audit Committee in relation to risk management are set out in the Audit Committee report on pages 52 to 55.

Financial risk management

Each business area produces an annual budget which is reviewed by senior management and ultimately approved by the Board. A longer-term plan is also in place which is updated annually and approved by the Board to enable it to have a clear longer-term view of financial projections.

We also prepare a monthly rolling forecast; performance against budget and the forecast is monitored at monthly ELT meetings and reviewed by the Board each month. Further information about the financial risk management policies in place, and, in particular, the way in which credit risk, liquidity risk, interest rate risk and foreign currency risk are managed, is in Note 27 to the financial statements.

Controls around consolidation

The basis of consolidation for the financial statements is detailed in Note 2 to the financial statements. Strong controls are in place around the process for preparing consolidated accounts. The work of consolidation is performed by experienced, qualified accountants and a review of the consolidation forms part of the audit work performed by our external auditors.

The principal risks and uncertainties facing the business are set out on pages 28 to 34 of the Strategic report.

Graham Holden
Chairman, Nomination Committee

Nomination Committee report

Director	Appointed to the Committee	Number of meetings	Out of possible
Graham Holden – Chairman	November 2007	6	6
Liz Barber	April 2015	6	6
Patrick De Smedt	January 2016	6	6
Peter Smith	January 2015	6	6

“The Board fully recognises the importance of the benefits of diversity of all types, including gender, professional and ethnic diversity.”

Dear shareholder

On behalf of the Nomination Committee and the Board, I am pleased to present the Nomination Committee report for the year ended 31 March 2018.

This has been a year of significant activity for the Nomination Committee with the announcement on 22 February 2018 of the start of a recruitment process to effect a managed succession for our Chief Executive, Bill Halbert. In addition, since the year end, on 17 May 2018, we have also announced the departure of our Chief Financial Officer, which will take effect on 30 June 2018.

The role of the Nomination Committee is to continually review the structure, size and composition of the Board and ensure that the balance of skills, knowledge and experience of the Board meets the requirements of the business, for both the current challenges and opportunities and the skills and expertise that are expected to be needed in the future.

Chief Executive succession

Our Chief Executive, Bill Halbert, joined KCOM in September 2006 as a Non-Executive Director and stepped up to an Executive role in July 2009. He has made a significant contribution to the development of the business and, under his leadership, the business has been fundamentally strengthened in terms of its financial position and its reputation in its chosen markets. The Nomination Committee met several times during the year to consider the future leadership needs of the business.

Nomination Committee report continued

Chief Executive succession continued

The outcome of these meetings was the decision that the Board should start seeking a successor to Bill, to lead the business in the delivery of its future strategy. This recruitment process, which is being overseen by the Nomination Committee, is well underway and an announcement of the outcome of the process will be made as soon as possible. The Committee has selected Lygon Group, as external independent advisors, to lead the search. In the meantime, Bill continues to drive the business forward and has agreed to remain with us to ensure an orderly handover of his responsibilities when needed.

Chief Financial Officer departure

After the year end, on 17 May 2018, we announced that Jane Aikman, our Chief Financial Officer, had decided to leave the business to pursue other opportunities. Jane will leave the business on 30 June 2018 and we wish her all the best for the future. The Nomination Committee oversaw the discussions with Jane regarding her departure and agreed the terms on which she left.

"The work of the Nomination Committee over the last 15 months has required considerable additional time from our independent Non-Executive Directors and I would like to thank them for their commitment to KCOM throughout."

As an interim measure Anna Bielby, one of our Finance Directors, has agreed to step up into the role of Chief Financial Officer, with effect from 1 July 2018. A process to recruit a permanent replacement for Jane will begin following the appointment of our new Chief Executive. Anna is a Fellow of the Institute of Chartered Accountants in England and Wales and has worked closely in a supporting role to the Chief Financial Officer at KCOM for the last four years. Anna is well known to the Board and the Committee believes she has the required skills not only to perform the role well but will also bring additional value to the organisation while doing so.

Developing talent

In addition to reviewing the composition of the Board, the Nomination Committee believes that it has a key role to play in developing talent in the organisation, to identify and promote those who are potential future Board members, either of KCOM or elsewhere. This includes ensuring that there are equal opportunities for development for both men and women.

Our gender pay gap report indicated that we have a number of traditionally male-dominated areas in our business where the ratio of male to female employees is not what we would want it to be. The Nomination Committee has requested that the Board has clear oversight of the initiatives being put in place across the business to encourage greater female participation in these fields, as well as the initiatives to encourage women to move through the various leadership levels of our organisation, through additional support and the removal of any obstacles that exist.

The full text of our gender pay gap report can be found on our website at www.kcomplc.com.

Thanks and feedback

The work of the Nomination Committee over the last 15 months has required considerable additional time from our independent Non-Executive Directors and I would like to thank them for their commitment to KCOM throughout.

Any feedback on the performance of the Nomination Committee is always welcome and this can be directed to me through our Company Secretary, Kathy Smith, who can be contacted at kathy.smith@kcom.com.

Graham Holden
Chairman, Nomination Committee
8 June 2018

The Nomination Committee is a sub-committee of the Board and meets as often as required each year. The membership and attendance at Committee meetings during the year are shown in the table on page 49.

Board Appointments policy and diversity

We have a Board Appointments policy, which sets out the procedure that will be followed in the event of a Board vacancy, along with our approach to diversity on the Board.

The key principle set out in the policy is that the Board will always seek to appoint on merit. The Board fully recognises the importance of the benefits of diversity of all types, including gender, professional and ethnic diversity, and will always aim to develop the diversity of the Board in order to promote a range of perspectives in the boardroom, while remaining true to the key principle of appointing on merit. We also have an Equality policy that applies across the Group to ensure we provide equality and fairness for all in our employment, and do not discriminate on any grounds. The policy sets out the responsibilities for all, the principles of equality and how these are applied to our employment practices.

The Board Appointments policy also states that the Nomination Committee will only use advisory firms that have signed up to the Executive Search Firms' Voluntary Code of Conduct, addressing gender diversity and best practice; that female applicants are given the same consideration and opportunity as male applicants; and that gender diversity is considered specifically when drawing up a list of potential candidates.

Balance of Executive and Non-Executive Directors (as at 31 March 2018)

Executive Directors	2	33%
Non-Executive Directors	4	67%

Balance of male and female Directors (as at 31 March 2018)

Male Directors	4	67%
Female Directors	2	33%

In addition, through the Board Appointments policy, the Board has committed to:

- continue to seek to identify and develop the talented individuals in the business, regardless of gender;
- review regularly the proportion of women at each level in the organisation to ensure that equal opportunities are being presented to individuals at every level; and
- always ensure that there is a confidential way in which concerns can be raised without fear of repercussion if anyone, regardless of gender, has a concern about the opportunities available to them.

We are proud to note that whilst the number of females in the organisation is 33 per cent of our total number of employees, the number of females in our ELT was at 38 per cent as at the year end, which is reflective of the equal opportunities that we provide across the organisation. We have also two female Directors on the Board and a female Company Secretary who participates fully in our Board and other meetings.

When Board vacancies arise, the Nomination Committee is responsible for preparing a description of the role and capabilities required for a particular appointment and then identifying and nominating candidates for the approval of the Board. In order to identify suitable candidates the Committee uses open advertising or the services of external advisors to facilitate the search, where appropriate.

Succession planning

The Committee is responsible also for considering succession planning for the Board and for key senior management across the business, although this is a matter also considered by the full Board.

For Board succession planning, the Committee works to the principle of continuity elsewhere on the Board, where possible, when planned changes take place at a senior level. The Committee has considered both short-term emergency succession planning and longer-term succession planning in the year.

Other Committee responsibilities

The Nomination Committee reviews annually the time required from each of the Directors to perform their roles effectively. Following this review, the Committee is satisfied that each of the Directors has committed sufficient time during the year to fulfil their duties as Directors of the Company.

The Committee reviews the re-appointment of all of the Directors standing for re-election at the AGM, giving regard to their performance and ability to continue to contribute to the requirements of the Board. The performance of Directors with more than six years' service is given particular attention, including a review of their independence, where applicable. The Nomination Committee then makes recommendations to the Board on whether each Director should be put forward for re-election. Information on the recommendations for re-election this year can be found on page 44.

The Committee's Terms of Reference are in line with the recommendations in the UK Corporate Governance Code and the Institute of Chartered Secretaries and Administrators' (ICSA) Guidance on Terms of Reference for Nomination Committees. Copies of the Terms of Reference are available from the Company Secretary and are on our website, www.kcomplc.com.

Liz Barber
Chairman, Audit Committee

Audit Committee report

Director	Appointed to the Committee	Number of meetings	Out of possible
Liz Barber – Chairman	April 2015	4	4
Patrick De Smedt	January 2016	4	4
Peter Smith	January 2015	4	4

Dear shareholder

On behalf of the Audit Committee and the Board, I am pleased to present the Audit Committee report for the year ended 31 March 2018.

The Audit Committee is a sub-committee of the Board and our role is to review all aspects of the financial reporting of the business and of internal control. As a Committee we seek to represent the interests of our shareholders in relation to the integrity of information and the effectiveness of the audit processes in place.

Committee meetings

This year we increased the number of meetings that the Committee has had from three to four, with the extra meeting being held in September to plan for the audit of the half-year numbers and to hear additional updates from the internal auditor. We intend to continue to hold four meetings a year in the future.

Internal and external audit

The Committee is responsible for overseeing the relationships with the internal and external auditors. Our external auditor, PricewaterhouseCoopers LLP, has been our auditor for 12 years. In the year ended 31 March 2017 we held a comprehensive, competitive tender process at which PricewaterhouseCoopers LLP was re-appointed, but with a revised audit team who were new to the business. We have monitored the relationship with PricewaterhouseCoopers LLP throughout the year and I have met with the audit team separately from the management team on a number of occasions. During the year the Financial Reporting Council (FRC) performed a review of the audit quality of our external audit for the year ended 31 March 2017 and they provided me with a copy of their report. While some areas for improvement were identified, the Committee was pleased to note that there were no findings that gave concern around the objectivity, quality or independence of the audit.

KPMG has continued to provide us with internal audit services during the year. Their audit plan is compiled from reviewing the key risks in the business, meeting with senior management and from their experience and knowledge of key risk areas in other similar businesses. Their audits this year have ranged from a detailed review of specific contracts in our Enterprise segment to a phishing exercise to test response rates across the business to identify specific security training needs. KPMG has brought in subject-matter experts as and when relevant to input to the audit scope and the actual audit work performed. We have received reports at each meeting on the adequacy of the controls in the audit areas and the progress in resolving the audit issues raised. I have had meetings with the internal auditor, away from the management of the business, a number of times during the year, to discuss the audit issues raised and the plan for future audits.

Significant issues relating to the financial statements

At each meeting there is a paper prepared by the Finance team on the significant accounting judgements made and the potential significant issues arising in the financial statements. This is reviewed and discussed in detail at each meeting and the external auditor is asked for their input. The significant issues discussed in the year have remained consistent with previous years and the Committee has been satisfied that the issues have been effectively managed throughout the year.

Feedback

The views of our shareholders are extremely important to us and any feedback on the work of the Audit Committee would be very welcome. Feedback can be given via our Company Secretary, Kathy Smith, who can be contacted at kathy.smith@kcom.com.

Liz Barber
Chairman, Audit Committee
8 June 2018

Composition

For the year under review, the Audit Committee has consisted of three Non-Executive Directors.

The table on page 52 shows the membership and attendance at Committee meetings during the year.

The Committee is chaired by Liz Barber, who is a Fellow of the Institute of Chartered Accountants in England and Wales and who currently works as Group Director of Finance, Regulation and Markets at Kelda Group, having previously been the Head of Audit for the North of England at Ernst & Young. Given her current and previous roles, the Board considers that she has the relevant recent financial experience necessary to fulfil the role of Chairman of the Audit Committee.

Committee meetings are also attended by the Executive Directors, the Finance Director for Group Finance Services, the Company Secretary and representatives from the internal and external auditors. The external auditor also meets with individual members of the Audit Committee during the year, without the other attendees present. The internal auditor also meets separately with the Chairman of the Audit Committee without the other attendees present.

Meetings

There were four meetings held in the year: in May, September, November and March. An overview of the key points considered at each meeting is shown below:

May 2017

> The risk appetite statement was reviewed and the updates from the previous version discussed and approved.

> The draft longer-term viability statement was reviewed and approved for inclusion in the Annual Report for the year ended 31 March 2017.

> The year end numbers were reviewed and the key accounting judgements made were discussed, with input from the external auditor.

> The external auditor gave an update on their year end audit work, including an overview of the controls work performed, and confirmed their continued independence.

> The non-audit fees for the year ended 31 March 2017 were reviewed and deemed satisfactory by the Committee.

> There was an update on the internal audit work performed since the previous meeting.

> The Committee reviewed all of the declarations that the Board would be expected to make in the year end accounts and noted these.

"The views of our shareholders are extremely important to us and any feedback on the work of the Audit Committee would be very welcome."

September 2017

> An overview of the key accounting judgements for the interim results was presented and discussed, with input from the external auditor on their planned interim work.

> An update of the work around the introduction of IFRS 15 on revenue recognition was presented and discussed.

> The external auditor provided an update on some work they had performed on the maturity of controls in relation to the SAP system.

> The proposed external audit fee for the year ended 31 March 2018 was agreed and the external audit plan was discussed.

> There was an update on the internal audit work performed since the previous meeting.

> An update on two whistleblowing matters was provided and discussed.

November 2017

> The half year numbers and key accounting judgements (in particular the accounting for provisions and losses in relation to complex customer contracts) were discussed, with input from the external auditor.

> An update of the ongoing work in relation to IFRS 15 on revenue recognition was presented and discussed.

> There was an update on the internal audit work performed since the previous meeting.

March 2018

> The declarations that would be required from the Committee and the Board at the year end were reviewed and discussed to ensure all were aware of the requirements.

> The proposed methodology for the longer-term viability statement was reviewed and discussed for the year ended 31 March 2018.

> The key accounting judgements in relation to the year end numbers were reviewed and discussed, with input from the external auditor.

> An update of the work in relation to IFRS 15 was given, including the assumptions made.

> The external auditor set out their approach for the year end.

> There was an update on the internal audit work performed since the previous meeting and the internal audit plan for the following financial year was discussed and approved.

Each year the Audit Committee is also responsible for:

> reviewing the financial statements of the Group and the clarity of the disclosures made, although the ultimate responsibility for reviewing and approving the Annual Report and financial statements remains with the Board;

> reviewing the effectiveness and independence of any whistleblowing investigations undertaken as a result of such concerns being raised;

> reviewing the procedures in place for the detection of fraud and the prevention of bribery across the business; and

> overseeing the relationship with the external auditor.

The Committee's Terms of Reference are in line with the recommendations in the UK Corporate Governance Code and the ICSA Guidance on Terms of Reference for Audit Committees. Copies of the Terms of Reference are available from the Company Secretary and are on our website at www.kcomplc.com.

Audit Committee report continued

External audit

The Audit Committee is responsible for overseeing the relationship with the external auditor to ensure that the external auditor continues to be independent, objective and effective in their work.

PricewaterhouseCoopers LLP was appointed as auditor in 2006 and the Committee undertook a competitive tender process, in accordance with the requirements of the Statutory Audit Services Order, in the year ended 31 March 2017. The outcome of this was that PricewaterhouseCoopers LLP was re-appointed as the external auditor as they were deemed to be the firm that best matched the criteria set out by the Committee.

There are no contractual obligations in place which would restrict the choice of external auditor by the Committee.

During the year the Audit Quality Review team of the FRC reviewed the work performed by PricewaterhouseCoopers LLP for the audit of KCOM for the year ended 31 March 2017. The FRC has provided a copy of their confidential report to the Chairman of the Committee, which has been reviewed and discussed by the Committee and with PricewaterhouseCoopers LLP. Whilst there were no significant findings, some areas of the external audit procedures were identified as requiring improvement and these have been reviewed in detail by the Chairman of the Committee. We are satisfied with the responses implemented by PricewaterhouseCoopers LLP for the audit of the Group's financial statements for the year ended 31 March 2018 and the Committee is content that the matters raised do not give it concerns over the quality, objectivity or independence of the audit.

The Audit Committee reviews the effectiveness of the external audit process throughout the year through meetings and through reviewing the reports provided by the external audit team. The Committee has concluded that the external audit process was effective during the year and is satisfied that the scope of the audit is appropriate and that significant judgements have been robustly challenged.

Policy on non-audit work

We have a policy in relation to the engagement of External Auditors which is regularly reviewed and updated to reflect the latest legislation as appropriate. This policy covers the selection of firms to perform non-audit work. It specifically excludes the auditor from providing specific services, such as certain tax services, any services that play a part in the management or decision-making of KCOM, book-keeping and preparing accounting records or financial statements, payroll services, the design and implementation of certain internal control or risk management procedures, valuation services, certain legal or human resources services, internal audit services and certain services linked to the financing, capital structure and investment strategy of KCOM. All other non-audit work is assessed separately and is awarded to the firm considered best suited to perform the work. Any such work must be agreed in advance by the Audit Committee Chair, work with a fee greater than 20 per cent of the annual audit fee must be approved by the Audit Committee before the external auditor may be appointed.

During the year, the fee for the external audit of the Group and its subsidiaries, along with other services pursuant to legislation, was £266,000 (2017: £262,000). In addition to this, the external auditor provided services to the value of £70,000 (2017: £77,000) relating to pension scheme and overseas subsidiary advice as well as consultancy in relation to ISAE3402 and SSAE16. In these areas the auditor was considered the most appropriate firm to perform the work.

Risk management and internal control

The Audit Committee reviews the Group's internal controls and risk management systems through the work performed by the internal and external auditors and reports to the Board on the effectiveness of such systems. The Committee is satisfied that any audit issues raised by either the internal or external auditors are being adequately followed up and closed on a timely basis.

Internal audit

During the year KPMG performed our internal audit work for us. The Committee believes that outsourcing the work of internal audit enables a broader scope and gives access to subject matter experts, which would not be possible with a solely in-house team.

The audit plan each year is created by looking at the risks across the business and prioritising audits accordingly, focusing specifically on the areas where the Board would most like assurance in relation to the controls in place. The audit plan is brought to the Audit Committee at the beginning of the financial year and then updated for each meeting as appropriate.

The internal auditor reports to the Audit Committee at each meeting on the adequacy and effectiveness of the financial, operational and compliance controls that have been tested across the Group. The Audit Committee is responsible for monitoring and reviewing the effectiveness of the internal audit work and does this through reviewing the internal audit reports presented to the Committee and through the Chairman of the Audit Committee meeting separately with the internal auditor outside of the Committee.

The Committee also reviews the adequacy of management responses to the audit issues raised and monitors the closure of issues on a timely basis through a regular report from the internal auditor.

The internal and external audit teams work closely together to ensure that all key risk areas are covered as appropriate and that the work performed by one team feeds into the work of the other.

During the year, the work performed by KPMG included a detailed review of specific contracts in the Enterprise segment, reviews of the risk management processes in place across the Group, the compliance project in relation to GDPR, the controls in relation to capital expenditure and procurement and a review of resource planning. In addition a phishing exercise was performed to test response rates and to identify specific areas where targeted training may be required.

Significant issues relating to the financial statements

The specific issues considered by the Audit Committee in the year under review, in relation to the financial statements, are shown in the table below. The Committee was satisfied that all of the issues considered were being effectively managed. More details on our critical accounting judgements and the key sources of estimation in relation to these are included in Note 3 to the accounts.

Nature of the issue	How the Committee was satisfied with the treatment adopted by management	Any changes arising from discussion by the Committee
Valuation of goodwill		
Testing goodwill for potential impairment is complex and requires a number of management judgements and estimates to be applied. This is a recurring matter.	Goodwill impairment calculations compare the value in use of the Group's Cash Generating Units with their carrying values. Value in use calculations are based upon the Board approved budgets with judgements made over discount rates and future growth assumptions. The goodwill impairment calculation was consistent with previous years except for the inclusion of additional sensitivity analysis to demonstrate the possible impact of key assumptions. The goodwill impairment calculation and sensitivity analysis was reviewed by the Committee, along with the judgements and estimates made. These were discussed in detail and it was concluded that there was no impairment and that the planned disclosure of the enhanced sensitivity analysis was appropriate.	The Committee reviewed the calculations in detail and challenged the judgements and estimates. The conclusion was that no changes were required.
Pension accounting assumptions		
Pension accounting is complex and there are a number of judgements and estimates that have to be made, which can have a significant impact on the valuation of scheme liabilities. This is a recurring matter.	The assumptions that had been made in relation to the pension accounting were reviewed by the Committee, which was satisfied that these were in line with recognised market practice and with the previous assumptions made. No changes were therefore required.	The assumptions were reviewed and challenged by the Committee. No changes were made as the Committee concluded that it agreed with the treatment adopted by management.
Classification of exceptional costs		
The accounting policy in relation to exceptional items has been refined in order to provide greater transparency and clarity to the users of the accounts. The refined policy and the judgement required in the application of the policy were both reviewed by the Committee. The consideration of the classification of exceptional items is a recurring matter when there are significant exceptional items.	The Committee believes that the revised policy provides a greater clarity of those items classified as exceptional. Management has followed the new policy during the year and therefore the Committee was satisfied with the treatment adopted by management.	No changes were made as the Committee was in agreement with the treatment and the policy changes made.
Significant contracts		
The Group has a number of significant customer contracts. These usually involve some judgement in relation to the timing of revenue recognition. This is a recurring matter.	A number of significant customer contracts have continued or been entered into during the year. Judgements made in relation to the larger contracts have been reviewed by the Committee in the year.	The Committee challenged some of the assumptions made and requested detailed information on some specific contracts from key members of staff directly involved in the contracts. The information provided satisfied the Committee that the policies applied, and the assumptions made, were appropriate and had been consistently followed.

Other disclosures

General information
General information is provided in Note 1 of the financial statements.

Disclosure of all relevant information to auditors
The Directors who approved this report are satisfied that, as far as they are aware, there is no relevant audit information (as defined in the Companies Act 2006) of which the Company's auditors are unaware. Each of the Directors has taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors
The names and biographical details of the Directors who served during the year are on pages 42 and 43. Further information regarding the Directors can be found on pages 58 to 74 in the Remuneration report.

Indemnification of Directors
The Company has indemnified each Director against liabilities incurred in connection with any claim brought against him or her, to the fullest extent permitted by the Companies Act 2006. The indemnity deed also obliges KCOM to maintain Directors' and Officers' insurance throughout the directorship and for six years after an individual ceases to be a Director.

Employees
Our people make the difference to our customers and our workplace and enable us to differentiate ourselves from our competitors. We therefore want our employment strategies to help our people develop to their full potential while also driving our business performance. Our employment policies are designed to provide equal opportunities irrespective of age, disability, ethnicity, gender, gender reassignment, marital and civil partnership status, nationality, pregnancy and maternity, race, religion and belief, and sexual orientation.

All employees, whether part-time or full-time, temporary or permanent, are treated fairly and equally. We select employees for employment, promotion, training or other matters affecting their employment on the basis of aptitude and ability.

We take every opportunity to involve and consult with our employees and we believe that employee involvement is an essential contributor to the development of our business. We have an employee forum made up of employees from across the business and they support and increase engagement with our strategy.

Our intranet is integrated with Yammer, which is a social media tool open to everyone in the business to post messages, share content and provide comments and feedback to others across the business. We have a weekly round-up email which keeps everyone informed of activities and developments across the Group, and a monthly newsletter called 'Leadingedge' which is sent to all people managers for them to share with their teams, which contains updates and useful information.

We also encourage our employees to become shareholders by offering a Share Incentive Plan (SIP) as we believe this is an opportunity to encourage greater employee engagement.

Share capital
The Company has a single class of share capital which is divided into ordinary shares of 10 pence.

Rights and obligations attaching to shares
In a general meeting of the Company voting is as follows:

- on a show of hands, every member present in person shall have one vote;
- on a show of hands, every proxy present who has been duly appointed by one or more members shall have one vote; and
- on a poll, every member who is present in person or by proxy shall have one vote for every share of which he or she is the holder.

A member is not entitled to vote in respect of any share in the capital of the Company held by him or her if there are sums payable to the Company in respect of such share which remain unpaid.

Full details of the deadline for exercising voting rights in respect of the resolutions to be considered at the AGM to be held on 20 July 2018 are set out in the Notice of Meeting.

All dividends are paid proportionately to the amounts paid up on the shares and are paid to those members whose names are on the share register at the date at which the dividend is declared, or at such other date as determined by the Directors or by an ordinary resolution of the Company.

If the Company is wound up, the liquidator, with the sanction of a special resolution of the Company or any other sanction required by law, may divide the whole or any part of the assets of the Company among the shareholders and may determine how the division of the assets will be carried out.

Transfer of shares
All transfers of uncertificated shares must be made in accordance with, and be subject to, the Uncertificated Securities Regulations 2001 as amended by the Uncertificated Securities (Amendment) Regulations 2013 and in accordance with any arrangements made by the Board.

All transfers of certificated shares must be in writing in a form which has been approved by the Directors; this is known as 'the Instrument of Transfer'. The Instrument of Transfer must be signed by, or on behalf of, the transferor and the transferor will remain as the holder of the share until the name of the transferee is entered into the share register.

The Directors may refuse to register the transfer of any share which is not fully paid or which is in favour of more than four persons jointly. The Directors may also refuse to recognise an Instrument of Transfer if it is not lodged at the Company's registered office or at any other place which the Directors have determined.

If the Directors refuse to register a transfer they will send to the transferee a notice of the refusal and the Instrument of Transfer within two months of the date on which the transfer was lodged with the Company.

Anti-corruption and anti-bribery
We have an Ethics and Anti-fraud policy which sets out our zero tolerance approach to corruption and bribery and the conduct expected of all our employees and contractors. We also have a Gifts and Hospitality policy which defines the process which must be followed before any gifts or hospitality are offered or accepted and a panel which has to give approval of any such gifts or hospitality. Regular reminders are sent to all employees to maintain awareness of these policies and processes.

Acquisition of own shares

At the AGM in 2017, the Company was authorised by members to purchase its own shares, up to a maximum of 51,660,391. During the year, the Company did not purchase any of its own shares.

The Company funds Employee Share Trusts (ESTs) to meet its obligations under the Company's share schemes. During the year the ESTs purchased 624,959 (2017: 2,130,491) shares on the London Stock Exchange with a nominal value of £62,496 (2017: £213,049), for which the Company provided funding of £450,000 (2017: £1,778,051). The purchased shares represent 0.1 per cent of the called-up share capital and are held in trust until they vest; therefore the purchase of these shares does not reduce the share capital in issue.

The total number of shares held in trust, which have not vested unconditionally to employees participation share schemes is:

	000s of shares
As at 1 April 2017	5,882
As at 31 March 2018	5,310

Further details around the purchase of shares in the year are set out in Note 26 to the financial statements.

Shares held by ESTs

The trustees of the Kingston Communications 2000 EST and the Kingston Communications All Employee Share Plan vote any shares held in the ESTs as they wish, having due regard to the interests of the employees as potential beneficiaries.

There are two other ESTs, the Kingston Communications Qualifying Employee Share Ownership Trust and KCOM Group PLC Employee Benefit Trust, that are currently dormant and hold no shares.

Requirements of Listing Rule 9.8.4R

None of the disclosures required by Listing Rule 9.8.4R are applicable to KCOM.

Significant agreements – change of control

The following significant agreements contain provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the Company:

> under our £180.0 million multi-currency revolving facility agreement dated 30 September 2016, the Company must notify Lloyds Bank PLC, the Agent of the agreement, within seven days of becoming aware of a change of control of the Company. Any bank or financial institution named within the facility agreement may then notify the Agent within seven days that they wish to cancel their commitments. The Agent must then give at least 21 days' notice to the Company of this and all outstanding amounts due to that bank or financial institution will become immediately due and payable. For these purposes, a 'change of control' occurs if any person or group of persons acting in concert gains control of the Company; and

> the Company's share schemes, details of which are contained in the Remuneration report on pages 58 to 74, contain provisions which take effect in the event of a change of control, as a result of which options and awards may vest and become exercisable. The provisions do not entitle participants to a greater interest in the shares of the Company than that created by the initial grant or award under the relevant scheme.

The Company does not have any agreements with any Director or employee that would provide compensation for loss of office or employment resulting from a takeover.

Strategic report

Pursuant to Section 414c of the Companies Act 2006 the Strategic report on pages 3 to 40 contains disclosures in relation to future developments, dividends, financial risk management and the disclosure of the Greenhouse Gas emissions for which the Company is responsible.

Annual General Meeting (AGM)

Our AGM will be held at the KCOM Stadium, Hull, on Friday 20 July 2018 at 1pm. The Notice of Meeting accompanies this Annual Report and is also available on our Group website at www.kcomplc.com. Four resolutions will be proposed as special business. Explanatory notes on these resolutions are set out in the Notice of Meeting.

The Directors consider that all the resolutions proposed are in the best interests of the Company and it is their recommendation that shareholders support these proposals as they intend to do so in respect of their own holdings.

This report has been reviewed and approved by the Board of KCOM Group PLC.

Signed by order of the Board

Kathy Smith
Company Secretary
8 June 2018

Remuneration report

Our information on Directors' remuneration is structured as follows:

> Annual statement from the Chairman of the Remuneration Committee, providing an overview of the key developments and remuneration decisions made during the financial year.

> Remuneration policy report, setting out the key elements of the current policy that was approved by shareholders in July 2017.

> Annual report on remuneration, showing how the current Remuneration policy has been applied in 2017/18, how we intend to apply the same policy in 2018/19 and a summary of the work of the Remuneration Committee in the year.

At our AGM in July 2018, shareholders will be asked to approve the Annual statement, together with the Annual report on remuneration, in an advisory shareholder vote.

Annual statement from the Chairman of the Remuneration Committee

Dear shareholder

On behalf of the Remuneration Committee and the Board, I am very pleased to present the Directors' Remuneration report for the year ended 31 March 2018.

Our current Remuneration policy was approved by our shareholders at our AGM in 2017 and we are not proposing any changes to the current policy. We have included a summarised version of the policy in the section entitled 'Remuneration policy report', for information.

The continued relevance of our Remuneration policy is something that we keep under regular review, taking into account the developments within the business, any relevant external changes and whether or not it continues to incentivise the behaviour and objectives that you, our shareholders, want from our Directors.

The Directors have a duty to promote the long-term success of the Company and we want to make sure that the Remuneration policy aligns with that duty. We believe that the policy remains fit for purpose and will reward fairly for good performance, allow greater rewards for extraordinary performance but not provide any additional rewards if performance is below expectations.

> "The Directors have a duty to promote the long-term success of the Company and we want to make sure that the Remuneration policy aligns with that duty."

Performance and decisions in the financial year

The results for the year to 31 March 2018 show an expected decrease in revenue but an increase in EBITDA. Our Hull & East Yorkshire segment continues to perform well whilst our Enterprise segment represents our long-term growth opportunity and our National Network Services segment saw an expected reduction in both revenue and contribution and continues to be managed for value. Consistent with our existing commitment to a minimum full year dividend of 6.00 pence per share, the Board is recommending a final dividend of 4.00 pence per share. Please see the Strategic report on pages 3 to 40 for further information on our performance in the year.

Pay review

As explained in our Remuneration report last year, no pay award was made to the Executive Directors in July 2017, which was a decision taken following a review of pay conditions across the business and taking into account the performance of the business at that time.

The Committee has once again considered whether a pay increase should be awarded to the Executive Directors with effect from 1 July 2018 and it has been agreed that no pay increase will be made. It is anticipated that there will be a small pay increase awarded across the rest of the business, however given the position that we find ourselves in this year, with a Chief Executive for whom a managed succession has been announced, and an interim Chief Financial Officer who will take up her role from 1 July 2018, it has been agreed by the Committee that a pay increase will not be awarded to the Executive Directors this year.

Annual bonus

The threshold pre-exceptional EBITDA target, required for a bonus to start to accrue, was set at £63.9 million in the year with a maximum set at £71.9 million. The pre-exceptional EBITDA achieved in the year was £68.3 million, which results in a bonus of 55.7 per cent of the maximum, this will be paid in July 2018. The Committee considered that the contributions of both Executive Directors in the year warranted payment of this bonus. Further information on the annual bonus scheme and the targets set in the year can be found on page 67.

Long Term Incentive Plan (LTIP) awards

The LTIP awards granted in July 2014 had a performance period which ended on 30 June 2017. The TSR growth for KCOM during the performance period was 13.0 per cent relative to a median growth in the comparator group of 25.5 per cent. This therefore meant that these awards did not vest. Further details on the LTIP and the performance measures can be found on page 67.

The LTIP awards granted in December 2015 have a performance period ending on 30 November 2018. Details of any awards that vest will be included in our Remuneration report next year.

In keeping with prior years, an LTIP award equivalent to 150 per cent of base salary was made to both Bill Halbert and Jane Aikman in July 2017. These awards are subject to relative TSR performance measured over a three-year performance period and the awards then have a further two-year holding period post vesting. Further information can be found on page 68.

Board changes

We announced on 17 May 2018 that Jane Aikman, our Chief Financial Officer, would leave the business on 30 June 2018 and on 4 June 2018 we announced that Anna Bielby, currently one of our Finance Directors, would step up, on an interim basis, into the role of Chief Financial Officer from 1 July 2018. On her departure, Jane will be paid amounts that are in line with her contractual entitlement for her 12-month notice period. Further information on the amounts to be paid are on page 69.

The remuneration to be paid to Anna is shown on page 69 of this report and is consistent with our existing Remuneration policy.

The Committee does not intend to make an LTIP award to Bill in the coming year given the announcement made in February 2018 regarding the managed succession for the Chief Executive role. Anna will receive an LTIP award in July 2018 in line with the level she would have received in her role as Finance Director, which in 2017 was equivalent to 20 per cent of base salary.

Feedback

We want to understand the views of our shareholders, including those in relation to remuneration. Any feedback would therefore be very welcome and may be directed to me via our Company Secretary, Kathy Smith, who can be contacted at kathy.smith@kcom.com.

Peter Smith
Chairman, Remuneration Committee
8 June 2018

Remuneration report continued

for the year ended 31 March 2018

Policy report

The Directors' Remuneration policy was approved by a binding shareholder vote at our AGM on 21 July 2017 and therefore became effective on that date. Our intention is to operate the policy, as approved, for the full three years to the 2020 AGM and we therefore do not propose to resubmit it to shareholders for approval at the AGM in July 2018. This part of the Directors' Remuneration report sets out an abridged version of the approved policy. A full version of the policy can be found on pages 52 to 62 of the Annual report and accounts 2016/17, which can be found on our website at www.kcomplc.com.

How does the Committee intend to exercise discretion?

The Committee operates the annual bonus, LTIP and all employee share plans in accordance with the relevant plan rules and, where appropriate, the Listing Rules and HMRC legislation. The Committee, consistent with market practice, retains discretion over a number of areas relating to the operation and administration of the plans. These include, for example, the timing of awards and setting performance criteria each year, dealing with leavers, discretion to retrospectively amend performance targets in exceptional circumstances (providing the new targets are no less challenging than originally envisaged) and in respect of share awards, to adjust the number of shares subject to an award in the event of a variation in the share capital of the Company.

Executive Directors' policy table

Element and how it supports the KCOM strategy	How does this operate and what is the maximum that may be paid?	What performance measures are used and why?	Are there any provisions to recover sums paid?
Base salary Setting the base salary at the right level enables us to attract and retain the high calibre individuals required to deliver the strategic objectives of the business.	We normally review base salaries annually with changes typically effective from 1 July. The review takes into account the salary increase budgeted for the workforce generally as well as any other key internal and external reference points, while also seeking to appropriately reflect the experience, calibre and performance of the individual. There is no prescribed maximum annual basic salary or salary increase. Increases will not normally exceed the general level of increase for employees across the business in percentage of salary terms; however, we may award higher increases in certain circumstances, for example, where there is a change in responsibility, progression in the role or a significant increase in the scale of the role or the size or complexity of the business. Details of the base salaries for each of the Executive Directors are shown in the Annual report on remuneration on page 69.	No specific performance measures are used in relation to determining base salary, but individual and business performance are considered as part of the discussion when setting the base salary levels.	There are no provisions to recover any sums paid.

Element and how it supports the KCOM strategy	How does this operate and what is the maximum that may be paid?	What performance measures are used and why?	Are there any provisions to recover sums paid?
Benefits Paying the right level of benefits helps us to attract and retain the right individual for the role.	The provision of benefits is set based upon general market practice, taking into account the benefits available to other employees across the business. The benefits available to Executive Directors may include a combination of: > private medical insurance for the Executive and their immediate family; > income protection; > life assurance; > car allowance of up to £16,000 per annum for the Chief Executive and up to £14,000 per annum for the Chief Financial Officer; > medical screening; and > the opportunity to participate in any all-employee Share Incentive Plans operated by the Company, in line with HMRC guidelines. Executive Directors will be eligible for any other benefits which are introduced for the wider workforce on broadly similar terms. We also reimburse our Executive Directors for any normal business-related expenses. The cost of benefits may vary from year to year and there is no maximum level set. The Executive Directors may purchase additional benefits via a deduction in salary through the flexible benefits arrangements that are available to all employees.	Benefits are not performance related.	There are no provisions to recover any sums paid.
Retirement benefits Retirement benefits are paid as part of a market competitive package which, in turn, helps us to attract and retain high calibre individuals.	Executive Directors are entitled to receive an employer defined contribution or cash allowance (or combination of the two) of up to 20 per cent of base salary.	Retirement benefits are not performance related.	There are no provisions to recover any sums paid.

Remuneration report continued

Policy report continued

Executive Directors' policy table continued

Element and how it supports the KCOM strategy	How does this operate and what is the maximum that may be paid?	What performance measures are used and why?	Are there any provisions to recover sums paid?
Annual bonus The annual bonus is designed to incentivise and recognise the achievement of specific annual objectives in support of the short to medium-term strategy of the business.	The annual bonus is normally payable in cash. The level of award is determined by the Committee after the year end, based on performance against the targets set at the beginning of the year. All bonus payments are at the ultimate discretion of the Committee. A sliding scale of targets is set, with 10 per cent of maximum being payable for achieving the threshold hurdle, rising to 50 per cent of maximum at target level and with payments of up to 100 per cent of salary at maximum.	The performance measures may be financial or non-financial measures but will be selected by the Committee each year. Group financial measures, such as profit-related measures, will apply for the majority of the bonus. If used, personal or strategic objectives will be applied for the minority of the bonus. Measures and objectives will be determined over a one-year performance period. The measures in place for 2017/18 and those proposed for 2018/19 are set out in more detail on pages 67 and 69. In both years we have chosen EBITDA as the most appropriate measure for the annual bonus. The Committee believes that any incentive compensation should be appropriately challenging and tied to the delivery of targets relating to profit.	Clawback provisions may be invoked for material misstatement, errors in assessing performance conditions or gross misconduct.
Long-term incentives Long-term incentive schemes are used to drive growth in shareholder value and to ensure that there is a direct link between reward and superior shareholder returns.	Awards are normally made annually with awards taking the form of conditional rights or nil or nominal cost options. The Committee reviews the quantum of awards annually and monitors the continuing suitability of the performance measures. A holding period will apply to awards granted in the year ended 31 March 2018 and onwards. The holding period will require any shares that vest, after tax, to be held for a period of two years, even if this period extends beyond the Director leaving employment with KCOM. The plan allows a maximum award of 150 per cent of salary per annum and this would be the normal level of award made to the Executive Directors. The rules allow for awards of up to 200 per cent of salary to be made in exceptional circumstances. The Committee may determine at grant whether an amount, in cash or shares, equivalent to the dividends paid or payable on vested shares up to the vesting date may become payable; any amount payable may assume the reinvestment of dividends over the vesting period. Actual award levels will be disclosed each year in the Annual report on remuneration.	Awards will typically vest after no less than three years, subject to the achievement of pre-set performance criteria and continued employment. The key performance measure used currently is relative TSR and stretching targets relating to this are set and assessed by the Committee. However, different financial, share price or strategic-based performance measures may be set for future award cycles as appropriate to reflect the strategic priorities of the business at that time. In addition to the performance measures set out by the Committee, there will always be an underpin that the Committee must be satisfied that the financial and non-financial performance of the business over the performance period warrants the level of vesting. As with previous awards, the performance measure for the 2018/19 LTIP awards will be relative TSR. This was selected on the basis that it is aligned with the delivery of long-term returns to shareholders.	Clawback and withholding provisions may be invoked for material misstatement, errors in assessing performance conditions or gross misconduct.

Non-Executive Directors' policy table

Element and how it supports the KCOM strategy	How does this operate and what is the maximum that may be paid?
Fees Fees are set to recognise the responsibility and experience of the individual and enable us to attract and retain the right calibre of individual and the right blend of skills on the Board.	Fees are normally reviewed annually. Any increase will be guided by changes in market rates, time commitments and responsibility levels as well as by increases for the broader employee population. The Chairman is paid an all-encompassing fee to take account of all Board responsibilities. The other Non-Executive Directors receive a base fee with additional fees paid for additional responsibility, such as the chairing of a Committee and performing the role of Senior Independent Director. In exceptional circumstances, if there is a temporary yet material increase in the time commitments for Non-Executive Directors, the Board may pay extra fees to recognise the additional workload. We reimburse our Non-Executive Directors for any normal business-related expenses. **What performance measures are used and why?** Fees are not performance related; however, performance is addressed through regular one-to-one meetings between the Chairman and each Non-Executive Director. The performance of the Chairman is reviewed at regular one-to-one meetings between the Chairman and the Senior Independent Director. **When and how might the Committee exercise discretion in this area?** Changes to the fees of Non-Executive Directors are a Board decision rather than a Remuneration Committee decision and there is discretion in relation to the level of fees set, within the parameters noted. **Are there any provisions to recover sums paid?** There are no provisions to recover any sums paid.

Share ownership requirement

The Committee requires our Executive Directors to build a shareholding in KCOM at a level of at least 100 per cent of salary for our Chief Financial Officer and 200 per cent for our Chief Executive. We believe that requiring the Executive Directors to hold shares further reinforces the alignment between their interests and those of shareholders and reduces the potential for behaviours and actions which are detrimental to the long-term health of the Company. It is expected that Executive Directors will reach this level through the retention of shares that have vested in the LTIP, on a net of tax basis.

The share ownership of all of our Directors, and their connected persons, as at 31 March 2018 is shown on page 73.

Remuneration report continued

Policy report continued

Recruitment policy

The remuneration package for a new Executive Director would be set in accordance with the terms of the prevailing approved Remuneration policy at the time of appointment, taking into account the skills and experience of the individual, the market rate for a candidate of that experience and the importance of securing the relevant individual.

This table sets out our policy on the recruitment of new permanent Executive Directors for each element of the remuneration package.

Element	Policy on recruitment
Base salary	The salary would be provided at such a level as required to attract the most appropriate candidate. Where it is appropriate to set a lower salary initially, a series of increases above the level awarded to the wider workforce may be given over the proceeding few years until the desired position is achieved, subject to individual performance. This may apply to those promoted internally in the business as well as to those recruited from outside.
Benefits	The benefits package we will offer will be set in line with the policy for existing Executive Directors. In addition to the benefits currently available to existing Executive Directors, we may also offer an allowance to cover relocation, travel and/or incidental expenses as appropriate.
Retirement benefits	The maximum pension contribution will be set in line with the policy for existing Executive Directors at 20 per cent of base salary.
Annual bonus	We will offer an annual bonus in line with our policy for existing Executive Directors of up to 100 per cent of salary. Different performance measures may be set initially, at the discretion of the Committee, depending on the point in the financial year at which the individual joins. The opportunity for an annual bonus will be pro-rated to the period of employment.
Long-term incentives	On an ongoing basis awards will be made in line with the policy for other Directors. In the year of recruitment a higher award may be made, at the discretion of the Committee, within the approved limits of the plan (200 per cent of salary in exceptional circumstances) and at a date outside of the usual annual awards.
'Buy-outs'	In addition to the above, we may also offer additional cash and/or share-based elements when we consider these to be in the best interests of shareholders and the business. Any such payments would be based solely on remuneration relinquished when leaving the former employer and would reflect (as far as possible) the nature and time horizons attaching to that remuneration and the impact of any performance conditions. Our policy on the 'buying-out' of existing incentives granted by the Executive's previous employer will depend on the circumstances of recruitment and will be negotiated on a case-by-case basis. There will not be a presumption in favour of buy-out but it will be considered if necessary to attract the right candidate.

In total the maximum variable pay level in the year of appointment – excluding the value of any buy-out awards – will be 300 per cent of salary; consisting of up to 100 per cent annual bonus and up to 200 per cent LTIP award.

For an internal executive appointment, any variable pay element awarded in respect of the prior role would be allowed to pay out according to its terms, adjusted as appropriate to take into account the appointment. In addition, any other ongoing remuneration obligations existing prior to appointment would be allowed to continue.

Post year end change of Chief Financial Officer

On 4 June 2018 we announced that Anna Bielby would be promoted internally to succeed Jane Aikman as Chief Financial Officer on an interim basis with effect from 1 July 2018. The package offered to Anna is consistent with the policy above, taking into account the interim nature of the appointment. Further details of the amounts to be paid to Anna can be found on page 69.

Non-Executive Directors

The fee structure for Non-Executive Director appointments will be based on the Non-Executive Director fee policy as set out in the policy table on page 63.

Service contracts
Our policy is to set notice periods for Executive Directors at 12 months for either party. Prior to 2017, the notice period for Executive Directors was set at six months. We have taken the decision not to retrospectively alter the notice period for those Directors appointed with a six month notice period. As an interim Executive Director, the notice period for Anna Bielby will continue at its current length of three months when she steps up into the role of interim Chief Financial Officer on 1 July 2018.

Letters of appointment
Non-Executive Directors are appointed by letters of appointment rather than service contracts and the notice period in all letters of appointment is set at six months for either party.

Copies of the Directors' service contracts and letters of appointment are available for inspection during office hours at our head office at 37 Carr Lane, Hull HU1 3RE. None of the service contracts or letters of appointment place obligations on us to make payments beyond those disclosed in this report.

Payments to Executive Directors who leave the business
The table below sets out our policy on payments in relation to Executive Directors who leave KCOM.

The Committee is clear that there will be a consistent approach to exit payments and no reward for poor performance. We will not pay anything if an Executive Director is dismissed for serious breach of contract, serious misconduct or under-performance or for acts that bring the Executive Director or KCOM into serious disrepute.

The Non-Executive Directors' letters of appointment do not include any compensation for loss of office.

Post year end exit of Jane Aikman

We announced on 17 May 2018 that our Chief Financial Officer, Jane Aikman, would step down from the Board on 30 June 2018. All payments made to Jane during the year and post year end have been made in accordance with our policy as stated on pages 60 to 65. Further details on these payments can be found on page 69.

Remuneration element	Treatment on exit
Base salary	Salary will be paid over the contractual notice period. In all cases we will seek to mitigate any payments due and the Executive Directors have a contractual duty to use reasonable endeavours to obtain alternative income, which can then be used to reduce the salary if being paid by instalments. However, we have discretion to make a lump sum payment on termination in lieu of notice.
Benefits and retirement benefits	Benefits and retirement benefits will normally continue to be provided over the notice period. In all cases we will seek to mitigate any payments due. However, we have discretion to make a lump sum payment on termination equal to the value of the benefits payable during the notice period.
Annual bonus	Whether an annual bonus payment is made is entirely at the discretion of the Remuneration Committee and would in any event be pro-rated to the time of active service in the year of cessation. The decision of the Committee would take into consideration the performance of the individual, the circumstances of the departure and the financial performance of the business.
Long-term incentives	Normally awards will lapse on cessation of employment, unless the Remuneration Committee determines that the Executive is a good leaver. Good leaver status is usually conferred for one of the following reasons: death, ill-health, injury or disability, retirement, redundancy, or other circumstances at the discretion of the Committee. Good leavers will be treated in accordance with the rules of the LTIP, as approved by shareholders. In these circumstances a participant's awards vest on a time pro-rata basis subject to the satisfaction of the relevant performance criteria over the original period, with the balance of the awards lapsing. The Committee retains discretion to decide not to pro-rate, to alter the basis of time pro-rating, and to alter the date on which performance is calculated if it feels such decisions are appropriate in particular circumstances.

In relation to a termination of employment, the Committee may make payments in relation to any statutory entitlement or payments to settle compromise claims as necessary. The Committee also retains the discretion to reimburse reasonable legal expenses incurred in relation to a termination of employment and to meet any transitional costs if deemed necessary. Payment may also be made in respect of accrued benefits, including untaken holiday entitlement.

Payments on a change of control, where a Director's employment is adversely changed, will be as on termination. There will be no enhanced provisions on a change of control.

Policy on outside appointments
We believe that where Board members hold directorships in other companies, KCOM can benefit from their experience. As a result, and subject to the Board's prior approval, Executive Directors may take on external non-executive directorships and retain the fees earned.

Remuneration report continued

Annual report on remuneration

This part of the Directors' Remuneration report sets out the amounts we have paid to Directors for the year ended 31 March 2018 and describes how the policy will be implemented in 2018/19. The Annual report on remuneration, along with the Annual statement from the Chairman of the Remuneration Committee, will be put to an advisory shareholder vote at the AGM on 20 July 2018.

The financial information contained in this part of the report has been audited where indicated.

Single total figure table (audited)

Executive Directors

	Current Directors				Previous Director			
	Bill Halbert		Jane Aikman		Paul Simpson[1]		Total	
	FY2018 £'000	FY2017 £'000	**FY2018 £'000**	FY2017 £'000	**FY2018 £'000**	FY2017 £'000	**FY2018 £'000**	FY2017 £'000
Fixed pay								
Base salary	**405**	403	**290**	133	**—**	132	**695**	668
Taxable benefits	**16**	16	**15**	7	**—**	8	**31**	31
Retirement benefits	**66**	66	**76**	9	**—**	25	**142**	100
Sub-total	**487**	485	**381**	149	**—**	165	**868**	799
Variable pay								
Annual bonus	**225**	—	**162**	—	**—**	—	**387**	—
Long-term incentives	**—**	377	**—**	—	**—**	249	**—**	626
Sub-total	**225**	377	**162**	—	**—**	249	**387**	626
Total	**712**	862	**543**	149	**—**	414	**1,255**	1,425

1. Paul Simpson stepped down from the Board on 30 September 2016.

Further details on Executive Director remuneration for the year ending 31 March 2018

Base salary

There has been no increase in the base salaries for either Bill Halbert or Jane Aikman in the year ended 31 March 2018. The increase year on year in the table is due to the increase made on 1 July 2016 which was only in place for nine months of the prior year.

Paul Simpson stepped down from the Board on 30 September 2016 but continued to receive his base salary, taxable benefits and retirement benefits as an employee of the business until the end of his notice period on 26 May 2017. These are disclosed on page 68.

Taxable benefits

Bill Halbert received a car allowance of £16,000 but elected not to receive any other taxable benefits. The taxable benefits for Jane Aikman included private medical insurance, income protection, life assurance, medical screening and a £14,000 per annum car allowance.

Retirement benefits

Bill Halbert has elected not to be a member of the KCOM pension scheme and, accordingly, we made no contributions on his behalf. Instead he received cash payments totalling £65,905 (2017: £65,905) which are disclosed above within retirement benefits.

Jane Aikman elected to receive part of her pension entitlement in cash. This amounted to £48,000 (2017: £Nil) for the year to 31 March 2018 plus £17,907 as an adjustment for an under-payment from the year to 31 March 2017. The contribution made by the Company to the KCOM pension scheme on behalf of Jane was £10,000 (2017: £8,792).

None of the Directors have any prospective entitlement to defined benefits or cash balance benefits in respect of qualifying services.

Annual bonus

The annual bonus figures included above relate to a bonus for the year ended 31 March 2018 which falls payable in July 2018. Further information on how this has been calculated and the performance targets achieved is on page 67.

Long-term incentives

The LTIP awards granted in July 2014 reached the end of their performance period in July 2017 but the performance targets were not met which meant that no awards vested in the year. Further details of the scheme are on pages 67 and 68.

Annual bonus

The annual bonus scheme for 2017/18 used pre-exceptional EBITDA as its key measure. A fixed level of pre-exceptional EBITDA was set at which a bonus pot would start to accrue, with a proportion of profits above that level being set aside for a bonus payment to all the scheme participants, up to the maximum level of bonus for all participants. The pre-exceptional EBITDA targets for 2017/18 are summarised in the table below:

Bonus level	EBITDA required net of bonus £'000
Maximum level – bonus fully paid	71,900
Target level – 50 per cent bonus paid	67,900
Trigger level – bonus starts to accrue	63,900

Why EBITDA?

EBITDA was chosen as the financial performance target for the annual bonus because this is a key performance measure used across our industry and one which is closely watched by our investors. Any significant movement in EBITDA has always led to a corresponding movement in our share price and therefore it is extremely important for our investors that the Executive Directors are incentivised to achieve an EBITDA above market expectations each year. EBITDA is one of the KPIs that we monitor throughout the year. More detail on our KPIs is on page 24.

The trigger level of EBITDA was set using 95 per cent of the market consensus for pre-exceptional EBITDA of £67.3 million.

The pre-exceptional EBITDA achieved in the year was £68.3 million. This equates to a bonus percentage of 55.7 per cent of the maximum bonus entitlement for all scheme participants. This will be paid in July 2018.

Long-term incentives

The current long-term incentive scheme, the LTIP, was approved by shareholders on 19 July 2012. The scheme authorises the Remuneration Committee to grant nil-cost share options to the Executive Directors and selected senior managers each year.

LTIP awards are usually made in July of each year. The scheme has a three-year performance period and measures TSR over the performance period, relative to the TSR performance of companies within a comparator group. The comparator group comprises the companies that were within the FTSE 250 (excluding investment trusts) at the start of the performance period.

The TSR performance for the period must rank at least median to the comparator group for there to be any vesting of the LTIP awards. Performance at median results in 25 per cent of the awards vesting, with performance between median and upper quartile resulting in a vesting of awards on a straight-line basis with 100 per cent vesting at upper quartile performance.

In addition, regardless of TSR performance, no awards vest unless the Remuneration Committee is satisfied that the financial and non-financial performance of KCOM over the performance period warrants the level of vesting set out in the vesting schedule. The Committee will consider KCOM's share price progression and dividend policy as part of this review.

On the exercise of an award participants receive an amount in cash equal to the dividends that were declared during the period from grant to exercise, but only in respect of the shares that vest.

The TSR performance is calculated as the percentage change in return index from the start to the end of the performance period. The return index is calculated by considering movements in share price together with dividends reinvested on the ex-dividend date. The base return index is averaged over each weekday in the three-month period immediately preceding the start of the performance period and the end return index is averaged over each weekday in the three months prior to the end of the performance period.

On 30 June 2017 the LTIP awards made in July 2014 reached the end of their performance period. The TSR for KCOM during the performance period was 13.0 per cent. The median for the comparator group was 25.5 per cent and the upper quartile TSR began at 65.9 per cent. The performance for KCOM therefore fell below the median and the awards did not vest.

The performance period for the LTIP awards made in December 2015 is due to end on 30 November 2018. Any amounts that vest will be included in the single total figure table for 2018/19.

Why TSR?

Our main objective is to create sustainable shareholder value. TSR measures the Total Shareholder Return from share price movements and dividends over a period of time. By measuring TSR relative to other businesses we can see whether an investment in KCOM has yielded value for our shareholders in comparison to the same investment in another business. This therefore exactly aligns the objectives of the Executive Directors to those of our shareholders. The three-year performance period, with a two-year post-vesting holding period for any shares awarded from the year ended 31 March 2018 onwards, means that the Executive Directors need to be focused on the medium to long-term if they want to maximise their benefit from the LTIP.

Remuneration report continued

Annual report on remuneration continued

Awards made under the LTIP (audited)

Awards of nil-cost options were made to Bill Halbert and Jane Aikman in July 2017, which were equivalent to 150 per cent of their base salaries. This was consistent with the prior year in quantum and timing.

As in previous years, the performance condition for these awards is TSR performance relative to the FTSE 250, excluding investment trusts, at the start of the performance period. The performance period for these awards is three years beginning on the first day of the month of grant.

	Date of grant	Share price at date of grant	Nil-cost options outstanding on 1 April 2017 000s of options	Nil-cost options awarded in the year 000s of options	Nil-cost options vested during the year 000s of options	Nil-cost options lapsed during the year 000s of options	Nil-cost options outstanding on 31 March 2018 000s of options	Face value of maximum award[1] £'000	Award that would vest at threshold performance[2] 000s of options	Date of vesting
Bill Halbert	17.07.2014	95.00p	418	—	—	(418)	—	—	—	17.07.2017
	16.12.2015[3]	110.25p	540	—	—	—	540	595	135	16.12.2018
	08.07.2016	108.00p	562	—	—	—	562	607	141	08.07.2019
	07.07.2017	89.50p	—	678	—	—	678	607	170	07.07.2020
Jane Aikman	17.01.2017	89.25p	487	—	—	—	487	435	122	17.01.2020
	07.07.2017	89.50p	—	486	—	—	486	435	122	07.07.2020
Paul Simpson[4]	17.07.2014	95.00p	263	—	—	(263)	—	—	—	17.07.2017
	16.12.2015[3]	110.25p	172	—	—	—	172	204	43	16.12.2018

1. Face value has been calculated using the share price at the date of grant.
2. 25 per cent of the award vests at threshold performance.
3. The 2015 award was made in December instead of July due to the transaction to sell the UK national network infrastructure to CityFibre, which meant the Directors were privy to inside information from July until December 2015.
4. Paul Simpson was granted good leaver status upon leaving the business, as noted in the Remuneration report in 2016, and therefore will be eligible to receive these awards, subject to vesting conditions being met. The awards have been pro-rated to the date his notice period ended on 26 May 2017.

Payments for loss of office

There have been no compensation payments for loss of office in the period under review.

Payments to past Directors

Paul Simpson stepped down from the Board on 30 September 2016 but continued to receive his base salary, taxable benefits and retirement benefits as an employee of the business until the end of his notice period on 26 May 2017. The payments made to Paul in the year to 31 March 2018 consisted of £42,000 of base salary, £2,000 of taxable benefits and £8,000 of retirement benefits. These have not been included in the table on page 66 as he was not a Director when he received these payments.

No other payments were made to past Directors in the year.

Single total figure table (audited)

Non-Executive Directors

	Current Directors								Previous Director			
	Graham Holden		Liz Barber		Patrick De Smedt		Peter Smith		Tony Illsley[1]		Total	
	FY2018 £'000	FY2017 £'000	**FY2018 £'000**	FY2017 £'000	**FY2018 £'000**	FY2017 £'000	**FY2018 £'000**	FY2017 £'000	**FY2018 £'000**	FY2017 £'000	**FY2018 £'000**	FY2017 £'000
Fees	**128**	127	**50**	50	**54**	51	**50**	50	**—**	18	**282**	296
Total	**128**	127	**50**	50	**54**	51	**50**	50	**—**	18	**282**	296

None of the fees paid to Non-Executive Directors were increased during the year. The increase year on year in the table is due to the increase made on 1 July 2016 which was only in place for nine months of the prior year.

1. Tony Illsley retired from the Board on 22 July 2016.

Implementation of policy for 2018/19

The table below sets out how we will implement the Remuneration policy for the 2018/19 financial year:

Executive Directors

	Bill Halbert	Anna Bielby	Jane Aikman
Base salary	Bill's base salary will remain at £404,809.	Anna's base salary will be £240,000 from the date of her appointment as interim Chief Financial Officer on 1 July 2018. This reflects the lesser experience that Anna brings to the role upon appointment.	Jane's base salary will remain unchanged at £290,000 to the date of her leaving the business on 30 June 2018.
Benefits	The benefits to be provided remain unchanged from 2017/18. These include private medical insurance for the Executive and his or her immediate family, income protection, life assurance, a car allowance of £16,000 per annum for Bill and £14,000 per annum for the Chief Financial Officer, medical screening and the opportunity to participate in the all-employee Share Incentive Plan. The Executive Directors are also able to purchase additional flexible benefits which are available to all employees.		
Retirement benefits	The Executive Directors will receive an employer pension contribution or cash equivalent of 20 per cent of base salary. As an interim Executive Director, Anna will continue to receive her previous employer pension contribution of 15 per cent of base salary.		
Annual bonus	The performance measures for the annual bonus scheme for 2018/19 will remain the same as in prior years as EBITDA. A trigger level of EBITDA has been set. Achievement of EBITDA above this level will result in bonuses being accrued as a proportion of additional EBITDA. Payments will be made to all scheme participants on a sliding scale up to the maximum level of bonus entitlement, which for both Bill and Anna is 100 per cent of the base salary received in the year. The EBITDA targets are considered to be commercially sensitive and will be disclosed in the Annual report on remuneration next year. Given her departure from the business on 30 June 2018, Jane will not participate in the annual bonus scheme for 2018/19.		
Long-term incentives	The Committee does not intend to make an LTIP award to Bill given the announcement in February 2018 of the managed succession for the Chief Executive role. Anna will receive an LTIP award in July 2018 in line with the level she would have received in her role as Finance Director, which in 2017 was equivalent to 20 per cent of base salary. When either role is filled permanently during the year, the Committee would intend to grant awards to the permanent recruits in accordance with the Remuneration policy.		

Payment to Jane Aikman

On 17 May 2018 we disclosed the payments that will be made to Jane Aikman, following her departure from the business on 30 June 2018. These are all in accordance with our current Directors' Remuneration policy.

Jane will receive a lump sum payment in lieu of her notice period of 12 months in accordance with her contractual entitlement, calculated as the sum of her base salary of £290,000, and the value of benefits of £18,456 and retirement benefits of £58,000. The Company has also agreed to make a contribution to Jane's legal fees incurred in connection with her departure.

The Remuneration Committee has agreed that Jane will also receive the bonus for which she is eligible under the annual bonus scheme, due to her contribution to the business throughout the financial year. This is included in the Single total figure table on page 66.

Jane was granted awards under the KCOM LTIP in January 2017 and July 2017. The performance periods for these awards end in January 2020 and July 2020 respectively. As a good leaver, Jane will be entitled to receive any shares that vest under the LTIP, pro-rated to 30 June 2019 in line with her 12 month notice period. The actual amount of shares will therefore be calculated on each vesting date, in so far as performance conditions are met at that time. Full details will be disclosed in the Directors' Remuneration report in 2020 and 2021. Further details of the operation of the LTIP can be found on pages 67 and 68.

Remuneration report continued

Annual report on remuneration continued

Implementation of policy for 2018/19 continued

Non-Executive Directors

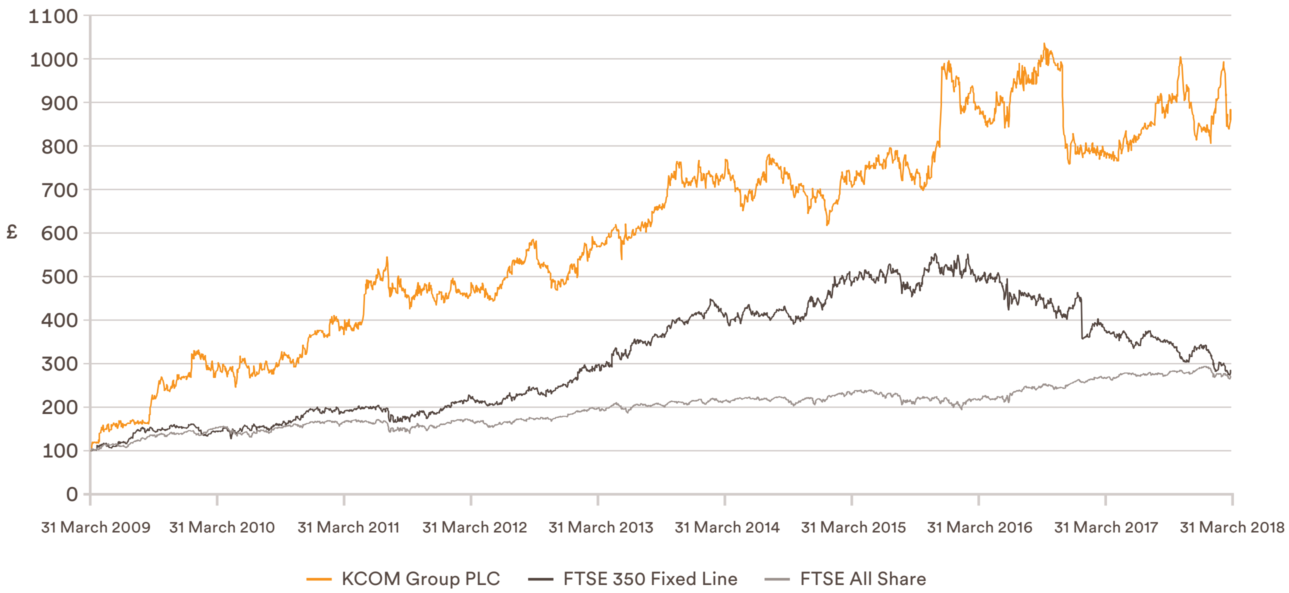
The fees of the Non-Executive Directors were reviewed by the Board in May 2018 and increases were proposed as shown below which will take effect from 1 July 2018. These increases reflect the fact that fees had not increased since July 2016 and an increase is anticipated for other employees across the business in July 2018.

The fees to be paid in the year are shown in the table below.

	Proposed £'000	Previous £'000	% increase
Chairman fee	132	127.5	3.5%
Base fee	45	43	4.7%
Senior Independent Director fee	11	11	—
Audit Committee Chairman fee	8	7	14.3%
Remuneration Committee Chairman fee	8	7	14.3%

Relative Group performance

The graph below shows, for the financial year ended 31 March 2018 and for each of the previous nine financial years, the TSR on a holding of KCOM's ordinary shares compared with a hypothetical holding of shares in the FTSE Fixed Line All-Share and the FTSE 250. These indices have been chosen as appropriate comparators because they reflect the performance of other companies most similar to KCOM in terms of product and service offering and market capital.



Remuneration of the Chief Executive

Bill Halbert became our Chief Executive on 1 April 2014, having previously been the Executive Chairman and performing a dual role of both Chief Executive and Chairman. The table below sets out the remuneration for Bill in his role as either Executive Chairman or Chief Executive in each of the last nine years:

	FY2018 £'000	FY2017 £'000	FY2016 £'000	FY2015 £'000	FY2014 £'000	FY2013 £'000	FY2012 £'000	FY2011 £'000	FY2010 £'000
Total remuneration	**712**	862	578	476	495	4,791	522	476	523
Annual bonus paid against maximum opportunity	**56%**	—	25%	—	7%	—	10%	—	40%
Long-term incentive vesting against maximum opportunity[1]	**—**	62.09%	—	N/A	N/A	69.34%	N/A	N/A	N/A

1. There was no long-term incentive scheme scheduled to vest based on performance ending in any of the financial years other than the years ended 31 March 2013 and from 31 March 2016 onwards.

The table below sets out the increase in the remuneration of the Chief Executive from the prior year in comparison to the average percentage change in respect of KCOM employees as a whole:

	Bill Halbert	Average per employee[1]
Percentage change in the year to 31 March 2018		
Base salary	0.00%	1.47%
Benefits	0.00%	0.00%
Annual bonus	100%	100%

1. The average per employee has been calculated on a per head basis using all of the employees in the business who have remained with the business throughout the year, excluding the Executive Directors and a few specific employees known to have received an increase purely because of a change in role. This group has been selected to enable as close to a like-for-like comparison as possible with the Chief Executive.

Relative spend on pay

The table below sets out the relative spend on pay for KCOM as a whole in comparison to distributions to shareholders:

	Year ended 31 March 2018 £'000	Year ended 31 March 2017 £'000	Percentage change
Total remuneration cost for all employees[1]	**80,350**	85,300	(5.80)
Dividend payments to shareholders	**30,996**	30,686	1.01

1. The total remuneration cost for all employees is taken from Note 8 to the financial statements on page 101 and includes wages and salaries, social security costs, other pension costs and share scheme costs.

Service contracts and letters of appointment

	Date of Board appointment	Date of current service contract or letter of appointment	Notice period (months)
Executive Directors			
Bill Halbert	1 September 2006[1]	17 June 2011	6
Jane Aikman	17 October 2016	21 July 2017	12
Non-Executive Directors			
Graham Holden	27 November 2007[2]	13 May 2014	6
Liz Barber	7 April 2015	30 March 2015	6
Patrick De Smedt	28 January 2016	12 January 2016	6
Peter Smith	5 January 2015	26 December 2014	6

1. Bill Halbert was a Non-Executive Director from the date of his Board appointment until 25 November 2008, when he became Executive Deputy Chairman. On 24 July 2009 he moved into the role of Executive Chairman. From 1 April 2014 the role of the Executive Chairman was split and Bill moved into his current role as Chief Executive.
2. Graham Holden was a Non-Executive Director from the date of his Board appointment until 1 April 2014, when he was appointed as Non-Executive Chairman.

Remuneration Committee

	Appointed to the Committee	Number of meetings attended	Out of possible
Peter Smith – Chairman since July 2015	January 2015	4	4
Liz Barber	April 2015	4	4
Patrick De Smedt	January 2016	4	4
Graham Holden	November 2007	4	4

The membership and attendance at Committee meetings during the year is shown in the table above. Meetings are also attended by the Chief Executive, the Head of Reward and the Company Secretary, although none are present when their own reward is discussed.

Remuneration report continued

Annual report on remuneration continued

Remuneration Committee continued

The Remuneration Committee is a sub-committee of the Board and has four scheduled meetings a year. Additional meetings are held as and when required. No additional meetings were required in the year.

The specific matters considered by the Committee at each of the meetings are shown in the table below.

Meeting	Matter considered
May 2017	> The bonus scheme for the 2017/18 year was discussed and it was agreed that it was appropriate to retain the same metrics as in the previous financial year and the specific targets for the year were confirmed. > The achievement of targets in relation to the annual bonus for 2016/17 was reviewed and it was noted that no bonus had been triggered.
July 2017	> The performance of the 2013 LTIP awards up to the end of June 2017 was reviewed and it was noted that the awards had not vested.
November 2017	> The performance metrics for the LTIP scheme were discussed and the potential inclusion of non-financial measures was considered. It was concluded that relative TSR continued to represent an effective and challenging measure for KCOM with strong alignment with shareholder objectives. > The performance metrics for the bonus scheme were also discussed and it was agreed that there would be consideration of the inclusion of non-financial measures for the 2018/19 scheme. > A governance update was received from the remuneration advisors, setting out governance developments and evolving best practice. This was discussed in relation to KCOM. The need for employee engagement in remuneration matters was an area for particular focus with actions raised to look into how this might be extended within KCOM. > An update on the gender pay disclosures to be made was tabled and discussed at the meeting.
March 2018	> The bonus scheme for 2017/18 was discussed and the provisional pre-exceptional number was reviewed. > The final draft of the gender pay disclosures was reviewed and approved.

During the year under review, the Committee received advice on all aspects of senior executive and non-executive director remuneration from independent remuneration consultants New Bridge Street, a trading name of Aon Hewitt Limited, an Aon plc company, which was appointed by the Committee in August 2011 following a comprehensive tender process. New Bridge Street is a signatory to the Remuneration Consultants Group Code of Conduct and any advice received is governed by that Code. The fee paid to New Bridge Street during the year for this advice was £14,633 (2017: £50,403) which is charged as a fixed annual fee for recurring work, with separate fees agreed as appropriate for additional ad hoc work.

The Committee has reviewed the way in which New Bridge Street operates and its relationship with the business and remains satisfied that the advice it receives is independent and objective. Aon Hewitt also provides actuarial and investment consultancy advice to the trustees of the two KCOM defined benefit pension schemes, which the Committee considers does not result in a conflict of interest.

In accordance with its Terms of Reference, the Committee is responsible for:

> determining and agreeing the Remuneration policy for the Executive Directors and selected senior managers across the business;
> having regard to remuneration trends across the business and remuneration in other companies when setting Remuneration policy, as well as to environmental, social and governance matters when appropriate;
> selecting, appointing and setting the Terms of Reference for any remuneration consultants who advise the Committee;
> approving the design of, and determining targets for, any performance-related pay schemes operated by the business and approving the total annual payments made under such schemes;
> reviewing the design of all share incentive plans for approval by the Board and shareholders and determining each year whether awards will be made and, if so, the overall amount of such awards, the individual awards and the performance targets to be used;
> determining the policy for, and scope of, pension arrangements for each Executive Director and selected senior managers; and
> ensuring that contractual terms on termination, and any payments made, are fair to the individual and the business, that failure is not rewarded and that the duty to mitigate loss is fully recognised.

The Committee's Terms of Reference are in line with the recommendations in the UK Corporate Governance Code and the Institute of Chartered Secretaries and Administrators' Guidance on Terms of Reference for Remuneration Committees. Copies of the Terms of Reference are available from the Company Secretary or on our website, www.kcomplc.com.

Directors' interests in shares as at 31 March 2018 (audited)

	Shares owned outright	Nil-cost share options subject to performance conditions[1]	Actual share ownership as a percentage of salary on 31 March 2018[2]	Required share ownership as a percentage of salary	Requirement met?
Executive Directors					
Bill Halbert	2,638,717	1,780,645	600.3%	200%	Yes
Jane Aikman	—	973,427	0%	100%	No[3]
Non-Executive Directors					
Graham Holden	50,000	—	—	—	—
Liz Barber	—	—	—	—	—
Patrick De Smedt	—	—	—	—	—
Peter Smith	—	—	—	—	—

1. These are awards made under the LTIP, further details of which can be found on page 68.
2. Calculated using the closing mid-market price of KCOM Group PLC shares on 31 March 2018 and only those shares owned outright by the Executive Director and their connected persons.
3. There is no fixed timescale set out in the Remuneration policy by which newly appointed Executive Directors should have met the shareholding requirement. The target will be met, at least in part, through a requirement to retain shares vesting in the LTIP scheme, on a net of tax basis.

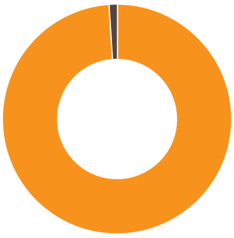
The table above sets out the interests of all the Directors as at 31 March 2018 (as listed on pages 42 and 43) and their connected persons in KCOM's shares.

Remuneration report continued

Annual report on remuneration continued

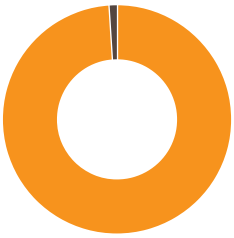
Shareholder views

At our AGM in 2017 there was a shareholder vote taken on the Directors' Remuneration report, excluding the Remuneration policy, and a separate vote on the Remuneration policy. The outcome of the votes is shown below:



Directors' Remuneration report (excluding the Remuneration policy)

Votes for:	363,889,096	(99.26%)
Votes against:	2,701,967	(0.74%)
Votes withheld:	10,052,922	



Remuneration policy

Votes for:	364,635,824	(99.47%)
Votes against:	1,942,022	(0.53%)
Votes withheld:	10,066,139	

Outside appointments

In 2017/18 Bill Halbert received no direct remuneration for his external non-executive positions. Jane Aikman became a Non-Executive Director of Morgan Advanced Materials plc on 31 July 2017 and received £37,748 in fees, which she was entitled to retain.

General information

Our closing mid-market share price on 31 March 2018 was 92.1 pence. The high and low closing mid-market share prices during the year were 110.0 pence and 86.3 pence respectively.

Signed by order of the Board

Kathy Smith
Company Secretary
8 June 2018

Financial statements

Independent auditors' report

to the members of KCOM Group PLC

Report on the audit of the financial statements

Opinion

In our opinion, KCOM Group PLC's group financial statements and parent company financial statements (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 March 2018 and of the group's profit and the group's and the parent company's cash flows for the year then ended;

> have been properly prepared in accordance with IFRSs as adopted by the European Union and, as regards the parent company's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and

> 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.

We have audited the financial statements, included within the Annual report and accounts (the 'Annual Report'), which comprise: the consolidated and parent company balance sheets as at 31 March 2018; the consolidated income statement and statement of comprehensive income, the consolidated and parent company cash flow statement, and the consolidated and parent company statements of changes in shareholders' equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

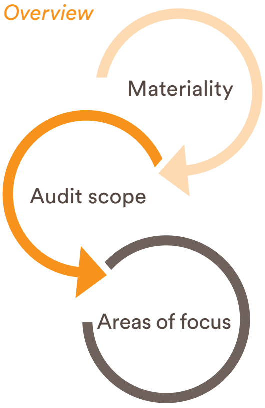
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the parent company.

Other than those disclosed in note 6 to the financial statements, we have provided no non-audit services to the Group or the parent company in the period from 1 April 2017 to 31 March 2018.

Our audit approach

Overview



Materiality

> Overall Group materiality: £1.7 million (2017: £1.9 million), based on 5% of profit before tax and exceptional items.

> Overall parent company materiality: £1.5 million (2017: £1.7 million), based on statutory materiality (of 1% of total assets) capped by group materiality.

Audit scope

> We conducted audit work over all components within the Group, which together, comprise 100% of profit before tax and exceptional items, revenue and net assets.

> The Group engagement team performed audits over all in scope components.

Areas of focus

> Significant contracts.

> Valuation of defined benefit pension scheme liabilities.

> Valuation of goodwill.

> Classification of exceptional items.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the group and the industry in which it operates, and considered the risk of acts by the group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the group and parent company financial statements, including, but not limited to, the Companies Act 2006, the Listing Rules, Pension legislation, UK tax legislation and certain aspects of telecommunications regulation under Ofcom. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with legal advisors, regulators and review of internal audit reports in so far as they related to the financial statements.

Report on the audit of the financial statements continued

Our audit approach continued

The scope of our audit continued

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Significant contracts (Group) The Enterprise segment in particular enters into arrangements with customers which can involve an implementation phase as well as subsequent ongoing in-life services. Judgement is required in separating these into individual elements. In addition, revenue from the initial implementation phase is generally accounted for on a percentage completion basis, by reference to progress in achieving delivery milestones or as a proportion of the total services to be provided. Where the costs to deliver a separate element exceed the anticipated revenues a provision for losses on this element is required. The accounting for these arrangements, as a result, requires judgement and relies upon an estimate of the costs to deliver the remaining services. Enterprise revenues were £88.3 million in the year and whilst the majority of this revenue is recurring or time and materials based, a proportion is subject to more judgemental percentage completion or fair value allocations. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates.	Our testing focused on the larger revenue-generating contracts in the year and on unbilled revenue at the year end where management have used judgement to recognise revenue on a percentage completion basis. In respect of sales contracts tested we checked that the fair value allocation of revenue between implementation and in-life services were in line with the terms of the sales contract and Group accounting policies. In particular we considered the appropriateness of the margins anticipated at each stage of the contract. For revenue accrued, or deferred, at the year end we tested the percentage completion to appropriate supporting project documentation including time forecasts, and to customer documentation without material exception. For loss making contracts we gained an understanding of and evaluated managements forecast costs to complete. We obtained corroborative explanations in support of the estimated remaining costs. We performed testing over revenue billed to date and over the costs incurred, including whether such costs had been allocated to the correct contract. Where a provision for forecast cost overruns on a contract element was required, we challenged management on the calculation of the provision and considered the extent of progress on these arrangements post year end. We assessed whether all loss making contracts had been identified. From our work we were satisfied that revenue recognised from significant contracts was materially appropriate and in line with the Group's policy.
Valuation of defined benefit pension scheme liabilities (Group) We focused on the valuation of the Group's defined benefit pension scheme liabilities because of the level of judgement required in determining the actuarial assumptions that underpin the year end liability valuation. The size of the scheme liabilities are significant (£261.8 million). See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates and Note 29 for detailed pension disclosures.	We obtained the IAS 19 valuation report produced by the Group's actuary based on the assumptions set by the Directors. We used our own actuarial experts to assess the judgemental assumptions used within the report to form the valuation of the pension schemes' liabilities, such as discount rate, inflation and mortality rates, and reviewed the accounting approach to ensure continued compliance with IAS 19. We have no exceptions to report as a result of this testing.

Independent auditors' report continued

to the members of KCOM Group PLC

Report on the audit of the financial statements continued

Our audit approach continued

Key audit matters continued

Key audit matter	How our audit addressed the key audit matter
Valuation of goodwill (Group) The Group has £51.4 million of goodwill. The carrying value of goodwill is supported by an annual impairment review. No impairment charge has been recorded by management in the current year. The risk we have focused on is that goodwill could be overstated and an impairment charge may be required. We focused on this area because the determination of whether or not goodwill is impaired involves subjective judgements and estimates about the future results and cash flows of the business. On an annual basis, management calculate the amount of headroom between the value in use of the Group's Cash Generating Units ('CGUs') and their carrying value to determine whether there is a potential impairment of the goodwill relating to those CGUs. The value in use of the CGU is dependent on a number of key assumptions which include: > Forecast cash flows for the next five years; > A long-term (terminal) growth rate applied beyond the end of the five year budget period; and > A discount rate applied to the model. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates and Note 14 for detailed goodwill disclosures.	We understood and evaluated managements budgeting and forecasting process. We obtained the Group impairment analyses and tested the reasonableness of key assumptions, including budgeted contribution and cash flow growth and the selection of discount rates and long term growth rates. We challenged the Directors key assumptions for the growth rates in the Group's forecasts by comparing these to external industry and economic forecasts. We challenged management to provide support to corroborate the trading assumptions within the Board approved budgets, including sales pipeline information, support for capital expenditure and considered the accuracy of previous forecasts. We challenged the Group discount rate by engaging our valuation specialists to assess the cost of capital for the Group and comparable organisations. We obtained and evaluated management's sensitivity analyses to ascertain the impact of reasonably possible changes in key assumptions and we performed our own independent sensitivity calculations to quantify the downside changes needed before any impairment would be required in individual CGUs. We determined that a movement in the key assumptions sufficient enough to cause an impairment in Enterprise was unlikely and that the disclosures made regarding the assumptions and sensitivities in relation to National Network Services were appropriate.
Classification of exceptional items (Group) Exceptional items consist of a number of one off costs relating to restructuring (£1.6 million) and a credit relating to regulatory matters (£2.4 million). Given the magnitude of these items we focused audit effort in this area to determine whether these items were appropriately classified as exceptional in accordance with the Group's policy and that the description of these amounts was consistent with the nature of the transactions. See the accounting policies section within the financial statements for disclosure of the related accounting policies, judgements and estimates and Note 7 for detailed exceptional items disclosures.	We tested the classification of exceptional items by evaluating the treatment of each class of exceptional item for compliance with the Group accounting policy, noting that the policy had been applied consistently for all items across the Group. We tested the underlying transactions by: > testing a sample of redundancy costs to payments made and whether the costs incurred were linked to transformational restructuring; and > testing costs and income in relation to regulatory matters to correspondence supporting those matters. Having performed this testing, we considered whether in our view the nature of the items supported separate classification as exceptional, in line with the Group's policy and whether the narrative descriptions were consistent with the nature of the items incurred. We are satisfied that whilst judgemental, materially, this is the case.

We determined that there were no key audit matters applicable to the parent company to communicate in our report.

Report on the audit of the financial statements continued

Our audit approach continued

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the parent company, the accounting processes and controls, and the industry in which they operate.

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the group, the accounting processes and controls, and the industry in which the group operates. The majority of trade and associated assets are held within one statutory entity KCOM Holdings Limited, alongside the KCOM Contact Centres business and a simplified holding company structure. Together these entities form the consolidated financial statements. KCOM Holdings Limited was considered to be the only financially significant component given that the vast majority of the Group's revenue and the majority of profit before tax and exceptional items was derived from this entity, however full audits were performed over all other components. Total coverage obtained through the audit of in scope components was 100% of Group revenue, Group profit before tax and exceptional items and net assets.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Overall materiality	£1.7 million (2017: £1.9 million).	£1.5 million (2017: £1.7 million).
How we determined it	5% of profit before tax and exceptional items.	Statutory materiality (of 1% of total assets) capped by group materiality.
Rationale for benchmark applied	We believe that profit before tax and exceptional items is a primary measure used by the shareholders in assessing the performance of the Group. Profit before tax is a generally accepted auditing benchmark. Exceptional items have been excluded from our materiality calculation to ensure that a consistent underlying measure has been used.	Total assets have been deemed an appropriate benchmark due to the parent company being a holding company.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £1.3 million and £1.6 million. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.1 million (Group audit) (2017: £0.1 million) and £0.1 million (Parent company audit) (2017: £0.1 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Directors' identification of any material uncertainties to the group's and the parent company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and parent company's ability to continue as a going concern.
We are required to report if the Directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Independent auditors' report continued

to the members of KCOM Group PLC

Report on the audit of the financial statements continued

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 March 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the group and parent company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

The Directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group

We have nothing material to add or draw attention to regarding:

> The Directors' confirmation on page 28 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.

> The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.

> The directors' explanation on page 34 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the group and statement in relation to the longer-term viability of the group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the 'Code'); and considering whether the statements are consistent with the knowledge and understanding of the group and parent company and their environment obtained in the course of the audit. (Listing Rules)

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

> The statement given by the Directors, on page 47, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and parent company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and parent company obtained in the course of performing our audit.

> The section of the Annual Report on page 55 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

> The directors' statement relating to the parent company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006 (CA06).

Report on the audit of the financial statements continued

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Directors' Responsibilities Statement set out on page 47, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the parent company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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
- certain disclosures of Directors' remuneration specified by law are not made; or
- the parent company financial statements and the part of the Directors' Remuneration report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 6 September 2006 to audit the financial statements for the year ended 31 March 2007 and subsequent financial periods. The period of total uninterrupted engagement is 12 years, covering the years ended 31 March 2007 to 31 March 2018.

Stuart Newman (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
8 June 2018

Consolidated income statement

for the year ended 31 March 2018

	Notes	2018 £'000	2017 £'000
Revenue	4	**301,898**	331,303
Operating expenses	5	**(265,462)**	(298,547)
Operating profit		**36,436**	32,756
Finance costs	9	**(2,399)**	(2,263)
Share of profit of associate	17	**12**	12
Profit before taxation	4	**34,049**	30,505
Taxation	10	**(6,571)**	(5,743)
Profit for the year attributable to owners of the Parent		**27,478**	24,762
Operating profit analysed as:			
EBITDA before exceptional items	4	**68,270**	67,645
Exceptional credits	7	**2,361**	—
Exceptional charges	7	**(1,638)**	(7,981)
Depreciation of property, plant and equipment	16	**(16,906)**	(14,279)
Amortisation of intangible assets	15	**(15,651)**	(12,629)
Earnings per share			
Basic	12	**5.38p**	4.85p
Diluted	12	**5.33p**	4.81p

The Company has elected to take the exemption under Section 408 of the Companies Act 2006 not to present the Parent Company income statement or statement of comprehensive income.

The profit for the Parent Company for the year was £31,446,000 (2017: £32,464,000).

Consolidated statement of comprehensive income

for the year ended 31 March 2018

	Notes	2018 £'000	2017 £'000
Profit for the year		**27,478**	24,762
Other comprehensive income/(expense)			
Items that will not be reclassified to profit or loss:			
Remeasurements of retirement benefit obligations	29	**4,203**	(12,035)
Tax on items that will not be reclassified	25	**(715)**	1,738
Total items that will not be reclassified to profit or loss		**3,488**	(10,297)
Total comprehensive income for the year attributable to owners of the Parent		**30,966**	14,465

The Notes on pages 87 to 120 are an integral part of these consolidated financial statements.

Balance sheets

as at 31 March 2018

	Notes	Consolidated 2018 £'000	Consolidated 2017 £'000	Parent Company 2018 £'000	Parent Company 2017 £'000
Assets					
Non-current assets					
Goodwill	14	**51,372**	51,372	**—**	—
Other intangible assets	15	**36,816**	45,709	**—**	—
Property, plant and equipment	16	**122,928**	106,323	**—**	—
Investments	17	**46**	45	**494,461**	494,461
Deferred tax assets	25	**4,376**	7,836	**—**	—
		215,538	211,285	**494,461**	494,461
Current assets					
Inventories	18	**3,713**	3,075	**—**	—
Trade and other receivables	19	**53,568**	68,406	**5**	5
Cash and cash equivalents	22	**13,223**	16,093	**—**	—
		70,504	87,574	**5**	5
Total assets		**286,042**	298,859	**494,466**	494,466
Liabilities					
Current liabilities					
Trade and other payables	20	**(87,281)**	(110,917)	**—**	—
Bank overdrafts	22	**—**	(5,903)	**—**	—
Finance leases	23	**(1,722)**	(1,942)	**—**	—
Provisions for other liabilities and charges	24	**(471)**	(377)	**—**	—
Non-current liabilities					
Trade and other payables	20	**—**	—	**(450)**	(450)
Bank loans	21	**(73,821)**	(48,587)	**—**	—
Retirement benefit obligation	29	**(7,507)**	(19,691)	**—**	—
Deferred tax liabilities	25	**(8,016)**	(7,498)	**—**	—
Finance leases	23	**(285)**	(2,094)	**—**	—
Provisions for other liabilities and charges	24	**(5,746)**	(1,962)	**—**	—
Total liabilities		**(184,849)**	(198,971)	**(450)**	(450)
Net assets		**101,193**	99,888	**494,016**	494,016
Equity					
Capital and reserves attributable to owners of the Parent					
Share capital	26	**51,660**	51,660	**51,660**	51,660
Share premium account		**353,231**	353,231	**353,231**	353,231
(Accumulated losses)/retained earnings[1]		**(303,698)**	(305,003)	**89,125**	89,125
Total equity		**101,193**	99,888	**494,016**	494,016

1. Included within consolidated (accumulated losses)/retained earnings is profit after tax of £27.5 million (2017: £24.8 million) for the Group and £31.4 million (2017: £32.5 million) for the Parent Company.

The Notes on pages 87 to 120 are an integral part of these consolidated financial statements.

The financial statements on pages 82 to 86 were approved by the Board of Directors and authorised for issue on 8 June 2018.

They were signed on its behalf by:

Bill Halbert
Chief Executive
8 June 2018

Jane Aikman
Chief Financial Officer

KCOM Group PLC
Registered number: 2150618

Consolidated statement of changes in shareholders' equity

for the year ended 31 March 2018

	Notes	Share capital £'000	Share premium account £'000	Accumulated losses £'000	Total equity £'000
At 1 April 2016		51,660	353,231	(288,624)	116,267
Profit for the year		—	—	24,762	24,762
Other comprehensive expense		—	—	(10,297)	(10,297)
Total comprehensive income for the year ended 31 March 2017		—	—	14,465	14,465
Deferred tax charge relating to share schemes	25	—	—	(122)	(122)
Purchase of ordinary shares	26	—	—	(1,778)	(1,778)
Employee share schemes		—	—	1,742	1,742
Dividends	11	—	—	(30,686)	(30,686)
Transactions with owners		—	—	(30,844)	(30,844)
At 31 March 2017		51,660	353,231	(305,003)	99,888
Profit for the year		—	—	27,478	27,784
Other comprehensive income		—	—	3,488	3,488
Total comprehensive income for the year ended 31 March 2018		**—**	**—**	**30,966**	**30,966**
Purchase of ordinary shares	26	—	—	(450)	(450)
Employee share schemes	8	—	—	1,785	1,785
Dividends	11	—	—	(30,996)	(30,996)
Transactions with owners		—	—	(29,661)	(29,661)
At 31 March 2018		**51,660**	**353,231**	**(303,698)**	**101,193**

The Notes on pages 87 to 120 are an integral part of these consolidated financial statements.

Parent Company statement of changes in shareholders' equity

for the year ended 31 March 2018

	Notes	Share capital £'000	Share premium account £'000	Retained earnings £'000	Total equity £'000
At 1 April 2016		51,660	353,231	89,125	494,016
Profit for the year		—	—	32,464	32,464
Total comprehensive income for the year ended 31 March 2017		—	—	32,464	32,464
Purchase of ordinary shares	26	—	—	(1,778)	(1,778)
Dividends	11	—	—	(30,686)	(30,686)
Transactions with owners		—	—	(32,464)	(32,464)
At 31 March 2017		51,660	353,231	89,125	494,016
Profit for the year		—	—	31,446	31,446
Total comprehensive income for the year ended 31 March 2018		**—**	**—**	**31,446**	**31,446**
Purchase of ordinary shares	26	—	—	(450)	(450)
Dividends	11	—	—	(30,996)	(30,996)
Transactions with owners		—	—	(31,446)	(31,446)
At 31 March 2018		**51,660**	**353,231**	**89,125**	**494,016**

The Notes on pages 87 to 120 are an integral part of these consolidated financial statements.

Cash flow statements

for the year ended 31 March 2018

	Notes	Consolidated 2018 £'000	Consolidated 2017 £'000	Parent Company 2018 £'000	Parent Company 2017 £'000
Cash flows from operating activities					
Operating profit/result		**36,436**	32,756	**—**	—
Adjustments for:					
– depreciation and amortisation	15,16	**32,557**	26,908	**—**	—
– increase in working capital		**(4,197)**	(18,302)	**—**	—
– (profit)/loss on sale of property, plant and equipment	5	**(15)**	555	**—**	—
– non-employee-related pension charges	29	**1,100**	655	**—**	—
– share-based payment charge	13	**1,785**	1,742	**—**	—
Payments made to defined benefit pension schemes	29	**(9,470)**	(7,724)	**—**	—
Tax paid		**(3,698)**	(8,019)	**—**	—
Net cash generated from operations		**54,498**	28,571	**—**	—
Cash flows from investing activities					
Purchase of property, plant and equipment		**(34,139)**	(28,403)	**—**	—
Purchase/generation of intangible assets		**(7,697)**	(15,792)	**—**	—
Proceeds from sale of property, plant and equipment		**517**	68	**—**	—
Dividends received		**—**	—	**31,446**	32,464
Net cash (used in)/generated from investing activities		**(41,319)**	(44,127)	**31,446**	32,464
Cash flows from financing activities					
Dividends paid	11	**(30,996)**	(30,686)	**(30,996)**	(30,686)
Interest paid		**(1,601)**	(1,257)	**—**	—
Capital element of finance lease repayments	22	**(2,099)**	(3,025)	**—**	—
Payment of loan issue costs		**—**	(720)	**—**	—
Repayment of bank loans	22	**(20,000)**	(15,000)	**—**	—
Drawdown of bank loans	22	**45,000**	65,000	**—**	—
Purchase of ordinary shares	26	**(450)**	(1,778)	**(450)**	(1,778)
Net cash (used in)/generated from financing activities		**(10,146)**	12,534	**(31,446)**	(32,464)
Increase/(decrease) in cash and cash equivalents		**3,033**	(3,022)	**—**	—
Cash and cash equivalents at the beginning of the year		**10,190**	13,212	**—**	—
Cash and cash equivalents at the end of the year	22	**13,223**	10,190	**—**	—

The Notes on pages 87 to 120 are an integral part of these consolidated financial statements.

01 General information

KCOM Group PLC is a public limited company, limited by shares, which is listed on the London Stock Exchange and incorporated and domiciled in the United Kingdom. The address of the registered office is 37 Carr Lane, Hull HU1 3RE. The nature of the Group's operations is described within the Strategic report on pages 3 to 40.

02 Accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

A number of accounting policies (revenue recognition, exceptional items, taxation, pensions and provisions) have been refined during the year. These policies have not changed in function, but the wording has been amended to improve clarity and transparency. Retrospective application of these accounting policy amendments would have no impact on the previously reported results.

Basis of accounting

The consolidated and Parent Company financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), IFRS Interpretations Committee and the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss. The financial statements have been prepared on a going concern basis.

The preparation of financial statements, in conformity with IFRS, requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3.

New accounting standards

The following amendments to standards published by the International Accounting Standards Board (IASB) were effective for the first time for the financial year beginning 1 April 2017:

> Improvements to IFRS 2014-2016

The annual improvements projects provide a vehicle for making non-urgent but necessary amendments to IFRSs, with the aim of removing inconsistencies and clarifying wording. The amendments related to IFRS 12 Disclosure of Interests in other Entities, aiming to clarify the scope of the standard, are effective for the financial year beginning 1 April 2017, whereas the rest of the improvements are effective for annual periods beginning 1 April 2018. As at 31 March 2018, the Group has no interests in entities that are classified as held for sale, as held for distribution or as discontinued operations, therefore the amendments related to IFRS 12 have no impact on the Group's consolidated financial statements.

> Amendments to IAS 7, Statement of cash flows on disclosure initiative

The amendments to IAS 7 require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows, such as the issuance and repayments of loans, and non-cash changes, such as unpaid acquisitions, sales and exchange differences. The Group has considered these amendments in the preparation of these consolidated financial statements.

> Amendments to IAS 12, Recognition of Deferred Tax Assets for Unrealised Losses

These amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value. These amendments do not have a significant impact on the results or financial position of the Group.

Notes to the financial statements continued

for the year ended 31 March 2018

02 Accounting policies continued

New accounting standards continued

New accounting standards, amendments and interpretations effective for annual periods beginning after 1 April 2018

The following accounting standards, amendments and interpretations have been issued but are not yet effective and have not been applied in preparing these financial statements.

Standards and amendments	Description	Date of mandatory application: annual periods beginning	Expected impact on consolidated financial statements
Amendments to IFRS 2	Clarifying how to account for certain types of share-based payments transactions	1 April 2018	No significant impact expected
IFRS 9	Financial instruments	1 April 2018	See below for expected impact
Amendments to IFRS 4	Impact of implementation of IFRS 9 on 'Insurance contracts'	1 April 2018	No significant impact expected
IFRS 15	Revenue from contracts with customers	1 April 2018	See below for expected impact
Amendments to IFRS 15	Clarifying guidance in IFRS 15	1 April 2018	See below for expected impact
Amendment to IAS 40	Clarifying that to transfer to or from, investment properties must have a change in use.	1 April 2018	No significant impact expected
Improvements to IFRS 2014-2016	Amendments to IFRS 1 'First-time adoption of IFRS' and IAS 28 'Investments in associates and joint ventures'	1 April 2018	No significant impact expected
Improvements to IFRS 2015-2017	Minor changes to IFRS 3 'Business combinations', IFRS 11 'Joint arrangements', IAS 12 'Income taxes' and IAS 23 'Borrowing costs'	1 April 2019	No significant impact expected
Amendments to IAS 28	Clarifying how companies account for long-term interests in an associate or joint venture to which the equity method is not applied using IFRS 9	1 April 2019	No significant impact expected
Amendments to IAS 19	Amendments regarding plan amendment, curtailment or settlement	1 April 2019	No significant impact expected
IFRS 16	Leases	1 April 2019	See below for expected impact
IFRS 17	Insurance contracts	1 April 2021	No significant impact expected
IFRIC 22	Foreign currency transactions and advance consideration	1 April 2018	No significant impact expected
IFRIC 23	Uncertainty of income tax treatments	1 April 2019	No significant impact expected

Adoption of the following accounting standards is expected to have a significant impact on our consolidated financial statements and/or our accounting policies:

IFRS 9

IFRS 9 replaces IAS 39 Financial Instruments – Recognition and Measurement and will be effective for annual periods beginning on or after 1 January 2018. Transition to IFRS 9 for the Group will take place on 1 April 2018 and therefore the results presented for the 2018/19 financial year will be the first presented in accordance with IFRS 9.

IFRS 9 introduces three key changes when compared to IAS 39 relating to: the classification and measurement of financial assets and financial liabilities; impairment of financial assets; and general hedge accounting.

Upon adoption of IFRS 9, financial assets will be reclassified into the categories required by the standard, however no significant impact regarding measurement of financial assets has been identified. For financial liabilities, the existing classification and measurement requirements of IAS 9 are largely retained.

The financial asset impairment requirements of IFRS 9 introduce a forward-looking expected credit loss model that results in earlier recognition of credit losses than the incurred loss model of IAS 39. The Group has performed a preliminary assessment of the adoption of the standard on the basis of average default risk of customers groups and will continue to analyse the impact during the 2018/19 financial year. We do not expect this to have a significant impact on the consolidated income statement or consolidated balance sheet.

The hedge accounting requirements of IFRS 9 have been simplified and are more closely aligned to an entity's risk management strategy. The Group does not currently hedge account, however IFRS 9 introduces a new hedge accounting model which is optional to apply and is closer aligned to commercial activities, such that it may be applied in the future if deemed appropriate.

With the exception of disclosure requirements, adoption of the new standard is not expected to have a significant impact on the Group because KCOM Group plc is not a financial institution, does not have any complex financial instruments, and does not currently apply hedge accounting. The Group is not required to restate 2017/18 comparatives however on 1 April 2018 an adjustment to reserves may be required as a result of the retrospective application of this standard.

02 Accounting policies continued

New accounting standards continued

IFRS 15

In May 2014, IFRS 15 'Revenue from contracts with customers' was issued for periods starting on or after 1 January 2018. Transition to IFRS 15 for the Group will take place on 1 April 2018 and therefore the results presented for the 2018/19 financial year will comply with IFRS 15 and the Annual report and accounts 2018/19 will be the first Annual Report presented in accordance with IFRS 15.

IFRS 15 sets out the principles for recognising revenue and costs from contracts with customers and includes extensive disclosure requirements. The Group must use a five step approach to allocate the revenue earned from contracts to individual performance obligations on a relative standalone selling price basis and recognise revenue as those performance obligations are satisfied.

Financial impact

There is no impact on the lifetime profitability of contracts or the cash flows associated with them. However, the Group expects the following ongoing effects from applying IFRS 15 to have the largest impact on the Consolidated Income Statement presented in the Annual report and accounts:

> Under current accounting, routers are capitalised and the expense recognised as depreciation over the term of the contract. Under IFRS 15 we will treat routers as a discrete sale and performance obligation, and as a result these assets will no longer be capitalised and the cost will be recognised as an operating expense at the point control passes to the customer. This is expected to impact our Hull & East Yorkshire market segment with a reclassification of costs from depreciation to other operating expenses resulting in a reduction of segmental contribution (and Group EBITDA) of c£2 million but it is expected to be relatively neutral at a profit before tax level.

> The guidance in IFRS 15 for the distinction between an agent and a principal is based on the concept of 'control' which differs from the currently applied notion of transfer of 'risks and rewards'. It is anticipated that some of our revenue within the Enterprise market segment previously recognised gross will be recognised net under IFRS as 'agency' revenue. The expected impact is to decrease revenue by c£3 million with no impact on profits.

> There are several other aspects of IFRS 15 which will change the timing of revenue and cost recognition but both individually and cumulatively these factors are expected to have an immaterial impact on the Consolidated Income Statement:

- Connection fees will be included in the transaction price and allocated to the performance obligations identified in the contract. This will result in the later recognition of revenue and profits and due to the timing of payments from customers a deferred income balance will arise. As connection fees are stable and broadly constant year on year, the impact on the income statement will be negligible.
- Currently sales commissions resulting directly from securing contracts with customers are expensed as incurred. Under IFRS 15, sales commissions will be recognised as an asset and amortised over the period in which the corresponding benefit is received, resulting in earlier profit recognition. Assuming commissions paid and the sales mix are similar year on year, the impact on the income statement will be insignificant.
- In multi-element contracts where subsidised equipment is delivered in advance (e.g. broadband service contract plus router or mobile service contract plus handset), a larger portion of the total transaction price is allocated to this component resulting in earlier revenue recognition. As a consequence, lower revenue is attributable to the provision of the service and a contract asset is generated during the contract for revenue recognised but not yet billed. Due to the relatively stable levels of equipment sales this is expected to have a negligible impact on the income statement for the financial year.
- IFRS 15 introduces a clear link between the value provided to a customer and the timing of revenue recognition. A small number of contracts have been identified within the Enterprise operating segment for which we have previously recognised revenue relating to the 'project phase' of the contract, but under IFRS 15 it has been determined that in these specific instances, the 'project phase' did not represent a separate performance obligation. Therefore a reduction in accrued income will be recognised upon transition to IFRS 15 and this will be released over the remaining term of the contract. In addition a new contract fulfilment asset will be recognised for the costs incurred during the 'project phase' which will also be released over the term of the contract.
- Generally the 'project phase' in Enterprise contracts results in the creation of an asset with no alternative use to the Group, however if we do not have an enforceable right to payment for performance completed to date then revenue should not be recognised over the contract phase, but instead at the point in time that control of the asset transfers to the customer which will result in later recognition of revenue.

Transition

IFRS 15 allows for two transition methods, namely the full retrospective method and the modified retrospective method with the cumulative effect from initial application recognised as an adjustment to the opening balance of retained earnings at the date of initial application. The Group will adopt the latter and prior year comparatives will not be restated; instead the Group will disclose the nature and the amount of the changes in items of the Balance Sheet and Income Statement for the current period as a result of applying IFRS 15 for the first time.

Notes to the financial statements continued

for the year ended 31 March 2018

02 Accounting policies continued

New accounting standards continued

IFRS 15 continued

Transition *continued*

Based on management's current estimate (excluding tax), the Group expects transition to the new standard to result in a movement in retained earnings of between a £0.5 million increase and a £0.5 million decrease. The effect will mainly be attributable to the first time recognition of:

> A contract asset arising from the earlier revenue recognition for the sale of routers which were previously accounted for as part of a bundle, offset by the de-recognition of routers previously capitalised;

> A deferred income balance relating to revenue previously recognised for professional services which under IFRS 15 does not represent a separate performance obligation, offset by a new contract fulfilment asset;

> A contract asset relating to deferred customer acquisition costs (e.g. sales commissions), which under IFRS 15 results in later recognition of selling expenses; and

> A deferred income balance relating to connections revenue which results in later revenue recognition under IFRS 15.

It is possible to elect to apply certain practical expedients to facilitate the application of the new standard. The Group has evaluated which of these practical expedients will be adopted on implementation of the standard with the objective of reducing the complexity of application. The main practical expedients which the Group intends to adopt are:

> Completed contracts – the Group will not apply the requirements of the standard retrospectively to contracts that are completed at 1 April 2018;

> Portfolio approach – the Group will apply the requirements of the standard to groups of contracts with similar characteristics (e.g. Hull & East Yorkshire consumers), since the effects of applying the standard to the groups identified, do not differ significantly from application of the standard on a contract by contract basis;

> Financing component – it will not be considered significant when the period between the moment when the promised good or service is transferred to a customer and the moment when the customer pays for that good or service is one year or less. Based on the assessment undertaken, the vast majority of contracts issued do not include a significant financing component; and

> Right to invoice - if the Group has the right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date we may recognise revenue in the amount to which the Group has a right to invoice.

IFRS 15 project

As part of our IFRS 15 project, the Group has determined its planned revenue and cost accounting policies under IFRS 15 and quantified the transitional adjustments required. The impact on tax, budgeting and forecasting, the bid and tender process and remuneration plans is currently being assessed. New processes and controls are being designed to allow for accurate reporting under IFRS 15 and a longer-term IT-based solution is under review.

Overall, the financial impact and transition adjustments detailed above are indicative based on our assessments undertaken to date. The actual impact of adopting IFRS 15 at 1 April 2018 may change due to a change in the sales mix and product offerings, and because the new accounting policies are subject to change until the Group presents its first financial statements which include the initial date of application.

IFRS 16

IFRS 16 replaces IAS 17 'Leases'; the standard will be effective for KCOM's year ending 31 March 2020 with early adoption permitted if IFRS 15 'Revenue from contracts with customers' has been adopted. We have decided not to early adopt this standard.

IFRS 16 will primarily change lease accounting for lessees. Lessor accounting under IFRS 16 is expected to be similar to IAS 17.

For lessees, operating lease arrangements will give rise to the recognition of a non-current asset representing the right to use the leased item and a loan obligation for future lease payables. Lease costs will be recognised in the form of depreciation of the right to use assets and interest on the lease liability. This will significantly impact the financial commitments detailed in Note 28 as a number of these lease obligations will be brought onto the Consolidated balance sheet.

The Group is continuing to assess the impact of IFRS 16, which is expected to have an impact on the Consolidated income statement and Consolidated balance sheet. We are yet to quantify this impact.

Basis of consolidation

Subsidiaries are entities controlled by the Company. Control exists when the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The consolidated financial statements include the financial statements of the Company and its undertakings made up to 31 March 2018. The results of new subsidiary undertakings are included from the dates of acquisition using the purchase method of consolidation. Where a company has ceased to be a subsidiary undertaking during the year, its results are included to the date of cessation.

02 Accounting policies continued

Basis of consolidation continued

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the income statement in the period of acquisition.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

Associates are entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's share of its associates' profits or losses is recognised in the income statement. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

Partnerships are controlled when the Group has the power, directly or indirectly, to govern the financial and operating policies of the partnership so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The consolidated financial statements include the financial statements of the KCOM Central Asset Reserve Limited Partnership and its undertakings made up to 31 March 2018. The results of new partnership undertakings are included from the dates of acquisition using the purchase method of consolidation. Where a company has ceased to be a partnership undertaking during the year, its results are included to the date of cessation.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker (CODM). The CODM, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the KCOM Group PLC Board of Directors.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods supplied, stated net of discounts, returns and value-added taxes. The Group recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Group's activities, as described below. The Group bases its estimate of return on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue from calls is recognised in the Consolidated income statement at the time the call is made over the Group's network. Revenue from rentals is recognised evenly over the rental period.

Revenue from product sales is recognised at the point of effective transfer of risk and reward. Revenue from production of directories is recognised at the point when the directory is published. For large long-term annuity and multiple element customer contracts the Group is able to distinguish between the installation and the in-life service phases of a contract. Contractually agreed revenues are recognised for each phase unless they do not represent a fair and market value for the work performed. Should contractually agreed revenues not represent a fair and market value then revenues are allocated between the two phases by reference to the overall contract margin, the expected costs of performing each phase and the typical selling prices had the phases been contracted separately. Revenue is recognised on the following basis for each phase:

> installation – within this phase revenue relating to resources and services is accounted for on a stage of completion basis with reference to the progress made towards fulfilling our contractual obligations. Revenue related to equipment is accounted for based on the point of effective transfer of risks and rewards (shipment); and

> in-life service – revenue for this phase is recognised in line with the obligation to provide service as dictated by customer contracts.

Pre-contract costs, such as bid costs, on key contract wins are expensed as and when incurred.

Revenue arising from the provision of other services, including maintenance contracts, is recognised in the accounting period in which services are rendered, by reference to stage of completion of the specific transaction, and assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Exceptional items

Exceptional items are presented whenever significant expenses are incurred or income is received as a result of events considered to be outside the normal course of business, where the unusual nature and expected frequency merits separate presentation to assist comparisons with previous periods. Items which are always classified as exceptional are:

> Regulatory matters;

> Onerous property leases;

> Impairment of goodwill; and

> Termination costs associated with Executive Directors.

Notes to the financial statements continued

for the year ended 31 March 2018

02 Accounting policies continued

Exceptional items continued

Restructuring and transformational costs are considered on a case by case basis as to whether they meet the exceptional criteria. Other items are considered against the exceptional criteria based on the specific circumstances. The presentation is consistent with the way financial performance is measured by management and reported to the Board.

Intangible assets

Goodwill

Goodwill represents amounts arising on acquisition of subsidiary undertakings and is the difference between the cost of the acquisition and the fair value of the net identifiable assets at the date of acquisition.

Goodwill is stated at cost less any accumulated impairment losses and is tested annually or more frequently if events or changes in circumstances indicate potential impairment. Impairment losses on goodwill are not reversed.

Goodwill is allocated to cash-generating units (CGUs) for the purpose of impairment testing. The allocation is made to those CGUs that are expected to benefit from the business combination in which the goodwill arose. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes.

Development costs

An internally generated intangible asset arising from the Group's internal development activities is recognised only if all of the following conditions are met:

> An asset is created that can be identified (such as new processes);
> It is probable that the asset created will generate future economic benefits; and
> The development cost of the asset can be measured reliably.

Internally generated intangible assets are carried at cost less accumulated amortisation and are amortised on a straight-line basis over their useful lives. Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Research costs are expensed to the income statement as and when they are incurred.

Customer and supplier relationships

Contractual customer and supplier relationships acquired in a business combination are recognised at fair value at the acquisition date. The contractual customer and supplier relations have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method over the expected life of the relationship. These intangible assets are amortised on a straight-line basis over their useful lives.

Technology and brand

Technology and brand acquired through business combinations are recorded at fair value at the date of acquisition. Assumptions are used in estimating the fair values of acquired intangible assets and include management's estimates of revenue and profits to be generated by the acquired businesses. These intangible assets are amortised on a straight-line basis over their useful lives.

Software

Software comprises computer software purchased from third parties and also the cost of internally developed software. Computer software purchased from third parties and internally developed software is initially recorded at cost.

Software development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Group are recognised as intangible assets when the criteria detailed above are met. These intangible assets are amortised on a straight-line basis over their useful lives.

Other software development expenditures that do not meet these criteria are recognised as an expense as incurred. Software development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Amortisation

Amortisation of intangible assets is charged to the income statement on a straight-line basis over the estimated useful life of each intangible asset. Intangible assets are amortised from the date they are available for use.

The estimated useful lives are as follows:

Customer and supplier relationships	up to 8 years
Technology and brand	up to 10 years
Software	up to 10 years
Development costs	3 years

02 Accounting policies continued

Property, plant and equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Network infrastructure and related equipment (included within exchange equipment and external plant) is recorded at cost including labour costs directly attributable to the cost of the network construction. Depreciation is provided so as to write off the cost of assets to residual values on a straight-line basis over the assets' useful estimated lives as follows:

Freehold buildings	40 years
Leasehold buildings and improvements	period of lease
Exchange equipment	10 years
External plant	10 to 40 years
Vehicles, other apparatus and equipment	1 to 10 years

Freehold land is not depreciated.

Exchange equipment includes assets and equipment which relate to the network. External plant relates to assets which connect the network to our customers.

The residual value, if not insignificant, is reassessed annually. Depreciation of network infrastructure and related equipment is provided for from the date the network comes into operation.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

Fixed asset investments

Fixed asset investments are shown at cost less provision for impairment. They are reviewed at each reporting date for possible reversal of the impairment.

Impairment of non-financial assets

Assets that have an indefinite useful life – for example, goodwill – are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Recoverable amount is the higher of fair value less selling costs and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units (CGUs) are allocated first to reduce the carrying amount of any goodwill allocated to CGUs and then to reduce the carrying amount of other assets in the unit on a pro-rata basis.

Inventories

Inventories are stated at the lower of cost or net realisable value. Cost is determined using the weighted average cost method. Costs include raw materials and, where appropriate, direct overhead expenses. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. Provision is made for obsolete, slow moving or defective items where appropriate.

Trade receivables

Trade receivables are recognised initially at fair value and measured subsequently at amortised cost, using the effective interest method, less any impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement within operating expenses. When a trade receivable is uncollectable, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts written off are credited against operating expenses in the income statement.

Cash and cash equivalents

Cash and cash equivalents includes cash in hand, short-term deposits and other short-term, highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts are shown in current liabilities on the balance sheet, unless a right of offset exists.

Notes to the financial statements continued

for the year ended 31 March 2018

02 Accounting policies continued

Trade payables

Trade payables are recognised initially at fair value and measured subsequently at amortised cost using the effective interest method.

Share capital

Ordinary shares are classified as equity.

Taxation

The tax expense represents the sum of the current tax and deferred tax expense.

The current tax is based on taxable profit for the year. Taxable profit differs from profit before tax as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and/or items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts 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 generally 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. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced or increased to the extent that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items recognised in other comprehensive income or directly to equity. In this case the deferred tax is also recognised in other comprehensive income or directly in equity, respectively.

Prior year adjustments to current and deferred taxes are recognised if the estimated tax position differs from the final tax position subsequently agreed with the taxation authority.

Research and development (R&D) tax reliefs are recognised as a credit to profit before taxation in the year in which relief is claimed. Claims for R&D relief can be made up to two years after the end of the accounting period to which it relates, therefore the period in which the claim is recognised is not necessarily the same as the period in which the costs were borne. Unclaimed reliefs are not recognised.

Financial instruments and hedge accounting

Financial assets and liabilities are recognised in the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its Treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are initially and subsequently recognised at fair value. Any gain or loss on remeasurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of the resultant gain or loss depends on the nature of the item being hedged.

The fair value of the interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in other comprehensive income and the ineffective portion is recognised immediately in the income statement. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in other comprehensive income are included in the initial measurement of the asset or liability. For hedges that do not result in recognition of an asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects net profit or loss.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement in the period.

02 Accounting policies continued

Foreign currency translation

These financial statements are presented in Pounds Sterling which is the currency of the primary economic environment in which the Group operates.

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

Leasing and hire purchase commitments

Leases where the Group assumes substantially all of the risks and rewards of ownership are classified as finance leases. Assets held under finance leases and hire purchase contracts are capitalised in the balance sheet at their fair value or, if lower, the present value of the future minimum lease payments and are depreciated over their useful economic lives. The capital elements of future obligations under finance leases and hire purchase contracts are included as liabilities in the balance sheet. The interest elements of the rental obligations are charged to the income statement over the periods of the leases and hire purchase contracts. The finance charge is allocated to each period during the lease so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the lease term.

Bank borrowings and issue costs

Bank borrowings are stated at the amount of proceeds after deduction of issue costs, which are amortised over the period of the loan. Finance charges, including direct issue costs are accounted for in the income statement on an accruals basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Borrowings are carried subsequently at amortised cost and any differences between the proceeds (net of transaction costs) and the redemption value are recognised in the income statement over the period of the borrowings using the effective interest method.

Pensions

Defined contribution

Obligations for contributions to the defined contribution (money purchase) scheme are charged to the income statement in the period they fall due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Defined benefit

For defined benefit retirement schemes, the cost of providing benefits is determined using a building block approach, with actuarial valuations being carried out at each balance sheet date. Remeasurements are recognised in full in the period in which they occur and are recognised in equity and presented in the Consolidated statement of comprehensive income.

The current and past service costs of the scheme (the increase in the present value of employees' future benefits attributable to the current or prior periods) are charged to the income statement in the period. The cost or benefit of committed settlements and curtailments is recognised immediately in the income statement. The interest cost of the scheme is recognised in the income statement in the period to which it relates.

The retirement benefit obligation recognised on the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost and as reduced by the fair value of scheme assets. Should an actuarial valuation result in a net asset position then the amount recognised will be limited to the recoverable amount. The recoverable amount shall be determined with reference to the agreements made between the Group and the Trustees within the pension scheme rules.

Employee share schemes and share-based payments

The Group has applied the requirements of IFRS 2. The Group issues equity-settled share-based payments to certain employees.

Equity-settled employee schemes, including employee share options and discretionary long-term incentive schemes, provide employees with the option to acquire shares of the Company. Employee share options and long-term incentive schemes are generally subject to performance or service conditions.

The fair value of equity-settled share-based payments is measured at the date of grant and charged to the income statement over the period during which performance or service conditions are required to be met, or immediately where no performance or service criteria exist. The fair value of equity-settled share-based payments granted is measured using either the Black-Scholes or Monte Carlo model, depending on the terms under which the options were granted. When determining the fair value of share options with a two year holding period, a Chaffe protected put method is used to apply a discount for the lack of marketability of the options. The amount recognised as an expense is adjusted to reflect the actual number of employee share options that vest, except where forfeiture is only due to market-based performance criteria not being met.

At the end of each reporting period, the Group revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The Group also operates a Share Incentive Plan (SIP) under which employees have the option to purchase shares in the Company each month and offers employees free matching and partnership shares on a sliding scale of between 1:3 to 2:1. The Group recognises the free shares as an expense over the period of any applicable service condition, or immediately when no service condition exists.

Notes to the financial statements continued

for the year ended 31 March 2018

02 Accounting policies continued

Dividends

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders or, in the case of interim dividends, paid.

Dividend income is recognised when the right to receive payment is established.

Provisions

A provision is recognised in the balance sheet when the Group has a present, legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Certain provisions are treated as exceptional items, as set out in our exceptional items accounting policy.

Provisions for onerous contracts are recognised should the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The estimated onerous element of the contract is recognised in full in the period in which the contract is identified as onerous. The assessment of whether a multi-element customer contract is onerous is undertaken separately for the installation and in-life phases should the revenues for that contract also be recognised on that basis.

03 Critical accounting judgements and key sources of estimation uncertainty

The table below shows the judgements which have the most significant effect on amounts that are recognised in the accounts, and the assumptions and estimates at the end of the current reporting year that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Area	Critical accounting judgements	Key sources of estimation uncertainty
Valuation of goodwill The valuation of goodwill is supported by an annual impairment review. Determining whether goodwill is impaired requires the carrying value to be compared to the value in use and/or the recoverable amount. This is derived from the business, or part of the business, or CGU, to which the goodwill has been allocated. The value in use is calculated using the present value of future cash flows expected to arise from the CGU, by applying an appropriate discount rate to the timing and amount of cash flows.	The Directors apply judgement in determining the appropriate discount rate using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the individual CGU. The Directors also apply judgement in determining a long-term (terminal) growth rate.	In order to calculate the value in use, the Directors are required to estimate the amount and timing of cash flows applicable to the CGU, based on current budgets and forecasts and extrapolated for an appropriate period taking into account growth rate and expected changes to selling prices and operating costs. Changes in estimates and judgements could result in a material adjustment to the carrying value of goodwill within the next financial year. The sensitivity of the valuation of goodwill for certain assumptions is detailed in Note 14.
Post-employment benefits The Group operates two defined benefit schemes. All post-employment benefits associated with these schemes have been accounted for in accordance with IAS 19 'Employee benefits (revised)'. As detailed within the accounting policies note, in accordance with IAS 19, all actuarial gains and losses have been recognised immediately through the Consolidated statement of comprehensive income.	Accounting for defined benefit pension schemes requires judgement over areas such as: > setting appropriate criteria to derive assumptions such as discount rates; and > the recognition of pension scheme assets (if applicable).	Several estimates contribute to the year end valuation including discount rates, inflation and rate of increase to pensions in payment. Changes to these estimates could result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Sensitivity analysis is provided in Note 29.

03 Critical accounting judgements and key sources of estimation uncertainty continued

Area	Critical accounting judgements	Key sources of estimation uncertainty
Exceptional items Exceptional items are presented whenever significant expenses are incurred or income received as a result of events considered to be outside the normal course of business, where the unusual nature and expected frequency merits separate presentation to assist comparisons with previous periods.	The Directors are required to make judgements regarding whether transactions are outside the course of normal business and whether the presentation of exceptional items will assist in providing a meaningful comparison of the Group's trading results with previous periods. In this financial year the Directors have made significant judgements regarding whether either the 'hereditament rate rebate' or 'losses on fixed price contracts' are exceptional items. It was concluded that the 'hereditament rate rebate' £4.4 million was not exceptional as previous charges (for which the rebate has been awarded) were themselves not exceptional items (as they were incurred in the normal course of business) and therefore presentation of the rebate as exceptional would not assist comparisons with previous periods. In addition, we expect items of this nature (rates rebates) to occur from time to time in the ordinary course of business. It was also concluded that 'losses on fixed price contracts' of £5.3 million were not exceptional as those losses arose as a direct consequence of actions made as part of the normal course of business. Judgements were also made around the classification of certain restructuring costs.	The Directors do not consider there to be any estimates made which could have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.
Significant contracts The Group, at times, enters into significant contracts with customers, which include both an 'installation' and an 'in-life service'. Revenue relating to the 'installation' phase is accounted for on a stage of completion basis. Revenue relating to the 'in-life service' is recognised in line with the satisfaction of the obligation to provide the service.	The Directors are required to make judgements when identifying the individual phases of the contract and determining the stage of completion.	Taking into account the number of contracts entered into the Directors do not consider there to be any individual estimates made which could have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

04 Segmental analysis

The Group's operating and reportable segments are based on the reports reviewed by the KCOM Group PLC Board which are used to make strategic decisions. The chief operating decision-maker of the Group is the KCOM Group PLC Board.

For the year ended 31 March 2018, the Board considered four segments in assessing the performance of the Group and making decisions in relation to the allocation of resources. These four segments are:

- Hull & East Yorkshire – providing communication and internet-based services to consumer and business customers within the region.
- Enterprise – providing consulting, design, implementation and managed services related to the collaborative systems and cloud markets.
- National Network Services – providing network connectivity and related services to business customers nationally.
- Central – holding the PLC costs and corporate costs, where allocation to the underlying segments would not improve understanding of these segments. These include costs associated with our defined benefit pension obligations and share schemes, alongside the residual cost of finance, HR, risk, legal and communications once appropriate recharges have been made to go-to-market segments.

Notes to the financial statements continued

for the year ended 31 March 2018

04 Segmental analysis continued

Segmental information has been prepared on a basis consistent with the prior financial year. The segment information provided to the KCOM Group PLC Board for the reportable segments, for the year ended 31 March 2018 and for the year ended 31 March 2017, is as follows:

		Revenue		Contribution[1]	
	Notes	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Before exceptional items					
Hull & East Yorkshire		104,216	102,275	65,660	60,424
Enterprise		88,285	90,966	5,115	4,500
National Network Services		113,212	141,811	9,021	15,959
Central		(3,815)	(3,749)	(11,526)	(13,238)
Total before exceptional items		301,898	331,303	68,270	67,645
Exceptional items					
Hull & East Yorkshire		—	—	(357)	(2,338)
Enterprise		—	—	(591)	(2,624)
National Network Services		—	—	2,059	353
Central		—	—	(388)	(3,372)
Total	7	—	—	723	(7,981)
Total		301,898	331,303	68,993	59,664

1. See glossary on page 121 for definition of contribution.

A reconciliation of EBITDA post-exceptional items to profit before tax is provided as follows:

	Notes	2018 £'000	2017 £'000
EBITDA post-exceptional items		68,993	59,664
Depreciation	16	(16,906)	(14,279)
Amortisation	15	(15,651)	(12,629)
Finance costs	9	(2,399)	(2,263)
Share of profit of associate	17	12	12
Profit before tax		34,049	30,505

Disclosure has not been made of segmental assets and liabilities. This is in accordance with IFRS 8 as this measure is not provided regularly to the KCOM Group PLC Board.

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

	2018 £'000	2017 £'000
Revenue from external customers		
Hull & East Yorkshire	100,375	97,921
Enterprise	88,285	90,966
National Network Services	113,212	141,811
Central	26	605
Total	301,898	331,303
Inter-segment revenue		
Hull & East Yorkshire	3,841	4,354
Central	(3,841)	(4,354)
Total	—	—
Group total	301,898	331,303

Inter-segment sales are charged at prevailing market prices.

04 Segmental analysis continued

None of the revenue, operating profit or net operating assets arising outside the United Kingdom are material to the Group. Revenue of £33.3 million from transactions with one customer within the Enterprise segment exceeded 10% of Group revenue. In the prior year, no external customers contributed in excess of 10% of Group revenue.

The analysis of the Group's revenue between sale of goods and the provision of services is as follows:

	2018 £'000	2017 £'000
Sale of goods	6,559	6,177
Provision of services	295,339	325,126
Group total	301,898	331,303

05 Operating expenses

Consolidated	Notes	2018 £'000	2017 £'000
Staff costs[1]		81,080	85,300
Restructuring costs relating to employees	7	1,638	3,439
Total staff costs	8	82,718	88,739
Own work capitalised	8	(7,168)	(7,187)
Other external charges		153,739	177,454
Non-employee-related pension charges	29	1,100	655
Operating lease rentals		3,632	3,259
Auditors' remuneration	6	336	339
Depreciation of property, plant and equipment	16	16,906	14,279
Amortisation of intangible assets	15	15,651	12,629
(Profit)/loss on disposal of property, plant and equipment		(15)	134
Hereditament rate rebate		(4,377)	—
Losses on fixed price contracts		5,301	3,704
Regulatory matters	7	(2,361)	710
Restructuring costs not relating to employees	7	—	3,832
Total		265,462	298,547

1. Included within staff costs are redundancy costs of £0.7 million which are not related to restructuring activities.

Other external charges mainly relate to costs from key partners, such as BT Wholesale. These external charges include managed service and maintenance contract costs along with product costs (for example, ethernet and broadband).

Non-employee-related pension charges represent the cost of administrating the pension schemes as set out in Note 29.

The Group received a multi-year rebate on network infrastructure hereditament (rateable value) of £4.4 million (2017: £Nil). The rebate has been recorded entirely in the Hull & East Yorkshire segment.

Losses of £5.3 million (2017: £3.7 million) relating to complex fixed price contracts with a specific customer were recognised in the year. Two of the contracts were exited before the year end. These losses have been recognised in the Enterprise segment.

Judgment over these last two items is further discussed in Note 3.

06 Auditors' remuneration

During the year the Group obtained the following services from the Company's auditors:

Consolidated	2018 £'000	2017 £'000
Fees payable to the Company's auditors for the audit of the Company's annual financial statements and the consolidated financial statements	48	49
Fees payable to the Company's auditors and their associates for other services:		
– the audit of the Company's subsidiaries	178	198
– audit-related assurance services[2]	40	15
– tax advisory services	—	30
– other non-audit services	70	47
Total	336	339

2. Relates to half year review and regulatory audit.

Notes to the financial statements continued

for the year ended 31 March 2018

07 Exceptional items

Consolidated	2018 £'000	2017 £'000
Regulatory matters	(2,361)	—
Credited to income statement	(2,361)	—
Restructuring costs	1,638	7,271
Regulatory matters	—	710
Charged to income statement	1,638	7,981
Net (credit)/charge to income statement	(723)	7,981

The Group recorded an exceptional credit of £2.4 million relating to regulatory matters (2017: charge £0.7 million). The credit resulted from an industry wide settlement which arose as a result of a breach in BT Openreach's contractual and regulatory obligations relating to compensation for misapplying 'Deemed Consent'.

The Group has incurred high levels of restructuring costs in recent years as part of transformation activity. The Directors recognise the need to differentiate those costs outside the normal course of business from the underlying trading performance. Management scrutinises all restructuring costs on a line by line basis in order to determine the appropriate treatment. During the year exceptional restructuring costs of £1.6 million were incurred in relation to four main areas:

> Strategic exit from certain products and markets (£0.4 million). This relates to the Group's decision to exit areas of the business that are not of strategic focus. The cost largely relates to the closure of our outsourced Contact Centres, within the Hull & East Yorkshire segment, on 31 March 2018 following the end of our largest customer contract. These activities have now been completed.

> Transformation of project delivery capability (£0.4 million). The Group has undertaken a discrete project designed to improve and de-risk our delivery of complex customer contracts. This transformation will enable us to deliver in-flight and future contracts more profitably and help avoid a reoccurrence of the losses on specific contracts incurred in both the current and prior years. We plan for this transformation to complete in the year ended 31 March 2019.

> Transformation of central functions (£0.4 million). The Group has carried out a structural re-organisation of some of its central functions, including HR and Legal, in order to deliver more efficient support for the go-to-market segments. These activities were completed in the year ended 31 March 2018. The Group has also begun a process of the centralisation of the technical and customer support teams into centres of excellence designed to provide an improved customer experience, which is scheduled to complete in the year ended 31 March 2019.

> Redundancy costs relating to prior year transformation activity (£0.4 million). These costs were incurred as a result of strategic decisions made in the prior year and finalised in the current year, in order to ensure we have the right people with the right skill set in the right areas. The benefits associated with these costs have been realised in the current financial year and are expected to continue into future periods.

The combined effect of these items is a charge of £0.1 million (2017: credit £1.6 million) in respect of current tax and £Nil (2017: £Nil) in respect of deferred tax.

Cash flow impact of exceptional items was an outflow of £1.1 million (2017: £8.3 million). The impact on working capital of exceptional items was an increase of £1.8 million.

08 Employees and remuneration

The average monthly numbers (including Executive Directors) employed by the Group during the year were as follows:

	Number of employees	
	2018	2017
Hull & East Yorkshire	316	349
Enterprise	87	69
National Network Services	31	48
Central	1,118	1,246
Total	1,552	1,712

Disclosed within the Central segment are employees who work in central functions (e.g. finance, legal, risk, etc). The costs are recharged to the applicable market segments as appropriate.

08 Employees and remuneration continued

The costs incurred in respect of these employees were:

	Notes	2018 £'000	2017 £'000
Wages and salaries[1]		69,485	72,608
Social security costs		6,804	7,355
Other pension costs	29	3,006	3,588
Share scheme costs	13	1,785	1,749
Restructuring costs relating to employees	7	1,638	3,439
Total		82,718	88,739
Less own work capitalised	15,16	(7,168)	(7,187)
Charged to the income statement		75,550	81,552

1. Included within wages and salaries are redundancy costs of £0.7 million which are not related to restructuring activities.

All of the Group's employees are employed by the Parent Company with the exception of 115 (2017: 138) employees employed by KCOM Contact Centres Limited. No employee costs are borne by the Parent Company.

Disclosures required by the Companies Act 2006 on Directors' remuneration, including salaries, performance-related bonuses, pension contributions and pension entitlements, including disclosure in respect of the highest paid Director, are included in the tables on pages 66 to 74 within the Remuneration report and form part of these financial statements.

09 Finance costs

Consolidated	Notes	2018 £'000	2017 £'000
Bank loans, overdrafts and other loans		1,583	1,195
Retirement benefit obligations	29	389	375
Finance lease and hire purchase contracts		69	110
		2,041	1,680
Amortisation of loan arrangement fees		234	583
Provision: unwind of discount	24	124	—
Total		2,399	2,263

10 Taxation

Analysis of tax charge in the year

The charge based on the profit for the year comprises:

Consolidated	Notes	2018 £'000	2017 £'000
UK corporation tax:			
– current tax on profits for the year		3,865	3,889
– adjustment in respect of prior years		(558)	(905)
Total current tax		3,307	2,984
UK deferred tax:			
Origination and reversal of timing differences in respect of:			
– profit for the year		1,740	1,356
– change in rate		(309)	672
– adjustment in respect of prior years		540	214
– charge in respect of retirement benefit obligation		1,293	517
Total deferred tax	25	3,264	2,759
Total taxation charge for the year		6,571	5,743

Notes to the financial statements continued

for the year ended 31 March 2018

10 Taxation continued

Factors affecting tax charge for the year

Consolidated	2018 £'000	2017 £'000
Profit before taxation	**34,049**	30,505
Profit before taxation at the standard rate of corporation tax in the UK of 19% (2017: 20%)	**6,469**	6,101
Effects of:		
– income not subject to tax	—	(379)
– expenses not deductible for tax purposes	**429**	40
– adjustment is respect of prior years	**(18)**	(691)
– change in rate reflected in the deferred tax asset	**(309)**	672
Total taxation charge for the year	**6,571**	5,743

The current tax charge of £3.3 million (2017: £3.0 million) includes £Nil (2017: £0.1 million credit) relating to the vesting of the share schemes which is a reclassification from the reserves on the unwind of the deferred tax asset.

Factors affecting the current and future tax charges

Changes to the UK corporation tax rates were substantively enacted as part of Finance Bill 2015 (on 26 October 2015) and Finance Bill 2016 (on 7 September 2016). These include reductions to the main rate to reduce the rate to 19% from 1 April 2017 and to 17% from 1 April 2020. Deferred taxes at the balance sheet date have been measured using these enacted tax rates and reflected in these financial statements.

11 Dividends

	2018 £'000	2017 £'000
Amounts recognised as distributions to equity holders in the financial year:		
– final dividend for the year ended 31 March 2016 of 3.94 pence per share	—	20,354
– interim dividend for the year ended 31 March 2017 of 2.00 pence per share	—	10,332
– final dividend for the year ended 31 March 2017 of 4.00 pence per share	**20,664**	—
– interim dividend for the year ended 31 March 2018 of 2.00 pence per share	**10,332**	—
Total	**30,996**	30,686

The proposed final dividend for the year ended 31 March 2018 is 4.00 pence per share, amounting to a total dividend of £20.7 million. 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 these financial statements.

12 Earnings per share

The calculation of basic and diluted earnings per share is based on the following numbers of shares and earnings:

Consolidated	2018 Number	2017 Number
Weighted average number of shares		
For basic earnings per share	**511,133,847**	510,384,583
Share options in issue	**4,730,273**	4,643,349
For diluted earnings per share	**515,864,120**	515,027,932

	2018 £'000	2017 £'000
Earnings		
Profit attributable to owners of the Parent	**27,478**	24,762
Adjustments		
Exceptional items	**(723)**	7,981
Tax on exceptional items	**137**	(1,596)
Adjusted profit attributable to owners of the Parent	**26,892**	31,147

12 Earnings per share continued

Consolidated	2018 Pence	2017 Pence
Earnings per share		
Basic	5.38	4.85
Diluted	5.33	4.81
Adjusted basic	5.26	6.10
Adjusted diluted	5.21	6.05

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Company and held in trust.

Adjusted basic earnings per share is calculated by adjusting the profit attributable to equity holders of the Company for the exceptional items net of taxation and dividing this adjusted figure by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the Company and held in trust.

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive ordinary shares. The dilutive potential ordinary shares are in the form of share options. A calculation has been done to determine the number of shares that would have been issued assuming the exercise of the share options.

Adjusted diluted earnings per share is calculated by adjusting the profit attributable to equity holders of the Company for the exceptional items net of taxation and dividing this adjusted figure by the weighted average number of shares outstanding assuming conversion of all dilutive ordinary shares.

13 Share-based payments

The Group had two share-based payment schemes (2017: three) in existence during the year ended 31 March 2018. The Group recognised a total charge of £1,785,000 (2017: £1,749,000) in the year relating to equity-settled share-based payment transactions.

In the prior year the Group operated a long-term incentive scheme (LTIS). No options remain relating to this scheme.

Share Incentive Plan (SIP)

The SIP is open to all employees. Under the SIP scheme, employees enter into an agreement to purchase shares in the Company each month. For each share purchased by an employee the Company awards matching shares on a sliding scale of between 1:3 to 2:1. The matching shares are held in trust and passed to the employee after five years' service. During this vesting period both shares purchased by the employees and matching shares are entitled to receive dividends which are used to buy additional shares.

Matching shares are allocated each month at market value with this fair value charge being recognised in the income statement over the vesting period. The cost recognised in the income statement relating to matching shares during the year was £662,000 (2017: £657,000). The number of matching shares granted by the Company during the year was 624,959 (2017: 646,786). The cash transferred by the Company in order to purchase these shares was £450,000 (2017: £600,000).

Long-Term-Incentive-Plan (LTIP)

The LTIP is an equity-settled share-based payment scheme open to the Executive Directors and selected senior employees at the discretion of the Remuneration Committee. The awards were granted at £Nil cost and vest dependent on TSR performance over a three year performance period relative to the TSR performance of each company within a comparator group. For Executive Directors only, the awards granted in the current year are subject to a two year holding period after the vesting date. For further information on the grants and the performance conditions, see the Remuneration report on page 67.

	Number	Weighted average exercise price (pence)
Outstanding at the beginning of the year	4,643,349	Nil
Granted during the year	1,979,211	Nil
Lapsed during the year	(1,892,287)	Nil
Outstanding at the end of the year	**4,730,273**	**Nil**

Notes to the financial statements continued

for the year ended 31 March 2018

13 Share-based payments continued

Long-Term-Incentive-Plan (LTIP) continued

For options granted in the year, the fair value per option granted and the assumptions used in the calculation of the value are as follows:

	Award without holding period	Award with 2 year holding period
Grant date	7 July 2017	7 July 2017
Share price at grant date	90.5p	90.5p
Number of employees	13	2
Shares under conditional award	814,728	1,164,483
Vesting period	3	3
Holding period	—	2
Expected volatility	23.19%	24.84%
Risk free rate	0.33%	0.56%
Dividend yield	Nil	Nil
Fair value per option at grant date	57.3	53.2
Valuation model	Monte Carlo	Chaffe[1]

1. Chaffe protective put method has been applied to determine the fair value of the options with the two year holding period. This method determines a discount for the lack of marketability of the options.

The expense recognised in the year in relation to the LTIP scheme was £1,123,000 (2017: £1,092,000).

14 Goodwill

Consolidated	Total £'000
Cost	
At 1 April 2016, 31 March 2017 and 31 March 2018	**85,272**
Provisions for impairment	
At 1 April 2016, 31 March 2017 and 31 March 2018	**33,900**
Net book value	
At 31 March 2018	**51,372**
At 31 March 2017	51,372
At 1 April 2016	51,372

Goodwill acquired in a business combination is allocated at the date of acquisition to the cash generating unit (CGU) that is expected to benefit from that business combination.

CGUs represent the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other groups of assets. As in previous years, KCOM's CGUs are based on customer type and geographic service location.

CGUs	2018 £'000	2017 £'000
Enterprise	**19,125**	19,125
National Network Services	**32,247**	32,247
Total	**51,372**	51,372

Goodwill is tested annually for impairment, or more frequently if there are indications that goodwill may be impaired. The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for these value in use calculations relate to forecast cash flows, discount rates and growth rates. The Directors estimate discount rates using pre-tax rates that reflect current market assessments of the time value of money and the level of risk. Growth rates reflect long-term growth rate prospects for the UK economy. The estimates used within our value in use calculation take into account historical experience and the Board's estimate of future events.

14 Goodwill continued

The discount rate and growth rate (in perpetuity) used for value in use calculations are as follows:

	2018	2017
Discount rate (pre-tax) Enterprise %	12.0	8.0
Discount rate (pre-tax) National Network Services %	9.4	8.0
Growth rate (in perpetuity) %	2.0	2.0

Cash flow forecasts are prepared using the current operating budget approved by the Directors, which covers a five year period and an appropriate extrapolation of cash flows beyond this. The cash flow forecasts assume revenue and profit growth in line with our strategic priorities.

The Group's impairment review is sensitive to a change in assumptions used, most notably the discount rates and the perpetuity growth rates.

A 0.1% increase in discount rates would cause the value in use of the Enterprise CGU to reduce by £3.7 million and the National Network Services CGU by £1.2 million.

A 0.1% reduction in perpetuity growth rates would cause the value in use of the Enterprise CGU to reduce by £2.8 million and the National Network Services CGU by £1.0 million.

The National Network Services CGU is highly sensitive to any reductions in short-term cash flows, whether driven by lower sales growth, lower operating profits or lower cash conversion. A 20% reduction in total annual operating profits would give rise to an impairment of £4m in the CGU. An increase in discount rates of 1.6% or a reduction in perpetuity growth rates of 2.0% would also give rise to an impairment in the National Network Services CGU.

15 Other intangible assets

Consolidated	Notes	Development costs[1] £'000	Software £'000	Customer and supplier relationships £'000	Technology and brand £'000	Total £'000
Cost						
At 1 April 2016		16,902	56,310	49,257	6,294	128,763
Additions		220	9,407	—	—	9,627
Own work capitalised	8	4,584	—	—	—	4,584
Disposals		(250)	(306)	—	—	(556)
Transfers		8,772	(8,766)	—	—	6
At 31 March 2017		30,228	56,645	49,257	6,294	142,424
Additions		510	2,280	—	—	2,790
Own work capitalised	8	3,856	124	—	—	3,980
Disposals		(27)	(266)	—	—	(293)
Transfers		132	138	—	—	270
At 31 March 2018		**34,699**	**58,921**	**49,257**	**6,294**	**149,171**
Accumulated amortisation						
At 1 April 2016		10,616	17,959	49,257	6,294	84,126
Charge for the year		4,647	7,982	—	—	12,629
Disposals		(4)	(36)	—	—	(40)
Transfers		1,631	(1,631)	—	—	—
At 31 March 2017		16,890	24,274	49,257	6,294	96,715
Charge for the year		4,652	10,999	—	—	15,651
Disposals		(1)	(10)	—	—	(11)
At 31 March 2018		**21,541**	**35,263**	**49,257**	**6,294**	**112,355**
Carrying amount						
At 31 March 2018		**13,158**	**23,658**	**—**	**—**	**36,816**
At 31 March 2017		13,338	32,371	—	—	45,709
At 1 April 2016		6,286	38,351	—	—	44,637

1. Development costs are predominantly capitalised staff costs associated with new products and services.

Notes to the financial statements continued

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16 Property, plant and equipment

Consolidated	Notes	Land and buildings £'000	Exchange equipment £'000	External plant £'000	Vehicles, other apparatus and equipment £'000	Total £'000
Cost						
At 1 April 2016		14,548	92,883	149,352	50,827	307,610
Additions		6	6,016	11,099	7,400	24,521
Own work capitalised	8	—	—	2,603	—	2,603
Disposals		—	—	(92)	(18)	(110)
Transfers		(24)	865	(405)	(442)	(6)
At 31 March 2017		14,530	99,764	162,557	57,767	334,618
Additions		—	7,785	15,262	7,766	30,813
Own work capitalised	8	—	402	2,714	72	3,188
Disposals		—	—	(40)	(243)	(283)
Transfers		—	1,150	(1,380)	(40)	(270)
At 31 March 2018		**14,530**	**109,101**	**179,113**	**65,322**	**368,066**
Accumulated depreciation						
At 1 April 2016		10,486	71,747	98,976	32,809	214,018
Charge for the year		352	2,255	4,228	7,444	14,279
Disposals		—	—	(1)	(1)	(2)
Transfers		—	50	192	(242)	—
At 31 March 2017		10,838	74,052	103,395	40,010	228,295
Charge for the year		353	2,571	5,420	8,562	16,906
Disposals		—	—	—	(63)	(63)
At 31 March 2018		**11,191**	**76,623**	**108,815**	**48,509**	**245,138**
Net book value						
At 31 March 2018		**3,339**	**32,478**	**70,298**	**16,813**	**122,928**
At 31 March 2017		3,692	25,712	59,162	17,757	106,323
At 1 April 2016		4,062	21,136	50,376	18,018	93,592

17 Investments

Consolidated	Shares in associate £'000
Cost	
At 1 April 2016	49
Share of net profit for the year	12
Dividends received from associate	(16)
At 31 March 2017	45
Share of net profit for the year	12
Dividends received from associate	(11)
At 31 March 2018	**46**
Amounts written off	
At 1 April 2016, 31 March 2017 and 31 March 2018	—
Net book value	
At 31 March 2018	**46**
At 31 March 2017	45
At 1 April 2016	49

17 Investments continued

Parent Company	Shares in subsidiary undertakings £'000
Cost	
At 1 April 2016, 31 March 2017 and 31 March 2018	494,511
Amounts written off	
At 1 April 2016, 31 March 2017 and 31 March 2018	50
Net book value	
At 1 April 2016, 31 March 2017 and 31 March 2018	494,461

Subsidiary undertakings (as at 31 March 2018)

Name of company	Place of registration	Holding	Proportion held	Nature of business
KCH (Holdings) Limited	England and Wales[1]	Ordinary shares	100%	Intermediate holding company
Network Holdco 3 BV*	Holland[2]	Ordinary shares	100%	Dormant
Smart 421 Technology Group Limited*	England and Wales[1]	Ordinary shares	100%	Dormant holding company
Kingston Network Holdings Limited*	England and Wales[1]	Ordinary shares	100%	Dormant holding company
Kingston Service Holdings Limited*	England and Wales[1]	Ordinary shares	100%	Dormant holding company
KCOM International Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
KCOM (General Partner) Limited*	Scotland[3]	Ordinary shares	100%	Intermediate holding company
KCOM Central Asset Reserve Limited Partnership*	Scotland[3]	Ordinary shares	100%	Partnership
KCOM Contact Centres Limited*	England and Wales[1]	Ordinary shares	100%	Provision of call centre facilities
Kingston Communications (Data) Trustees Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Kingston Communications (Hull) Trustees Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Affiniti Integrated Solutions Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Kingston Information Services Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
KCOM Holdings Limited*	England and Wales[1]	Ordinary shares	100%	Design and delivery of communication and integration services
Eclipse Networking Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Eclipse Internet Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Kingston Communications (Hull) Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Omnetica Investment Limited*	England and Wales[1]	Ordinary shares	100%	Dormant holding company
Omnetica Inc*	USA[4]	Ordinary shares	100%	Dormant
Smart421 Limited*	England and Wales[1]	Ordinary shares	100%	Dormant
Smart421 Solutions Inc*	USA[5]	Ordinary shares	100%	Dormant
SmartIntegrator Technology Limited*	England and Wales[1]	Ordinary shares	50%	Software development

* Indicates indirect shareholding.

1. 37 Carr Lane, Hull HU1 3RE.
2. Prins Bernhardplein 200, 1097 JB Amsterdam, The Netherlands.
3. 50 Lothian Road, Festival Square, Edinburgh EH3 9WJ.
4. 200 Knickerbocker Avenue, Bohemia, New York, 11716, USA.
5. 9 East Loockerman Street, Dover, Delaware, 19901, USA.

The Directors believe the values of the investments are supported by the underlying net assets of the subsidiaries.

Associates
The Group's associate is Smartintegrator Technology Limited, in which the Company indirectly holds 50% of the ordinary shares. Under an agreement between the shareholders of Smartintegrator Technology Limited, neither the Group nor the shareholders are able to exercise control over the operational and financial policies of Smartintegrator Technology Limited. The associate is registered in England and its main business activity is software development.

Notes to the financial statements continued

for the year ended 31 March 2018

18 Inventories

Consolidated	2018 £'000	2017 £'000
Raw materials and consumables	**3,326**	2,829
Equipment for resale	**387**	246
Total	**3,713**	3,075

There is no material difference between the carrying value and the replacement cost of inventories.

19 Trade and other receivables

	Consolidated		Parent Company	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Trade receivables (net)	**21,836**	31,835	**—**	—
Other receivables	**2,175**	274	**—**	—
Prepayments	**17,604**	21,767	**5**	5
Accrued income	**11,953**	14,530	**—**	—
Total	**53,568**	68,406	**5**	5

All of the Group's receivables are due within one year in both 2018 and 2017. An allowance has been made for estimated irrecoverable amounts from the sale of goods and services of £1,308,000 (2017: £828,000). The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

Movements on the Group provision for impairment of trade receivables are as follows:

	2018 £'000
At 1 April 2017	**(828)**
Written off in the year	**741**
Amounts provided for in the year	**(1,221)**
At 31 March 2018	**(1,308)**

The majority of the Group's trade and other receivables are denominated in Sterling.

Note 27 provides further disclosures regarding the credit risk of the Group's trade receivables.

As of 31 March 2018, trade receivables of £5,106,000 (2017: £4,787,000) were impaired. The amount of the provision was £1,308,000 as of 31 March 2018 (2017: £828,000). The individually impaired receivables mainly relate to customers who are in unexpectedly difficult economic situations. It was assessed that a portion of the impaired balance is expected to be recovered. There is no concern over the debt not yet due.

The ageing of these receivables is as follows:

	2018 £'000	2017 £'000
0–3 months	**4,154**	3,822
3–6 months	**952**	965
6 months+	**—**	—
	5,106	4,787

As of 31 March 2018, trade receivables of £4,234,000 (2017: £6,729,000) were past due but not impaired. These relate to a number of independent customers of whom there is no recent history of default. The ageing analysis of these trade receivables is as follows:

	2018 £'000	2017 £'000
0–3 months	**3,153**	5,527
3–6 months	**1,081**	1,202
6 months+	**—**	—
	4,234	6,729

20 Trade and other payables

	Consolidated		Parent Company	
	2018 £'000	2017 £'000	**2018 £'000**	2017 £'000
Current				
Trade payables	**38,005**	40,118	**—**	—
Other taxes and social security costs	**4,874**	7,493	**—**	—
Other payables	**2,521**	2,587	**—**	—
Accruals	**24,435**	31,909	**—**	—
Deferred income	**17,446**	28,810	**—**	—
Total	**87,281**	110,917	**—**	—
Non-current				
Amounts due to subsidiary undertakings	**—**	—	**450**	450
Total	**—**	—	**450**	450

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The Directors consider that the carrying amount of current liabilities approximates to their fair value.

Amounts owed to subsidiary undertakings are unsecured and have no fixed date of repayment. However, the subsidiary undertakings have confirmed that none of the amounts are due within one year. Interest at market rates is charged on amounts due to subsidiary undertakings after more than one year, except for amounts due to dormant entities where Nil interest is charged.

21 Bank loans

	Consolidated	
	2018 £'000	2017 £'000
Bank borrowings		
Amount falling due:		
– between two and five years	**75,000**	50,000
	75,000	50,000
Loan issue costs	**(1,179)**	(1,413)
	73,821	48,587

The loan facility was secured by guarantees given by all material subsidiaries of KCOM Group PLC in favour of the lending banks.

The bank borrowings are fully repayable in December 2021 and attract an interest rate of LIBOR plus a margin dependent on specific covenants. For further information on interest rate swaps, see Note 27.

22 Net debt

This section sets out an analysis of net debt and the movements in net debt for each of the financial years presented.

		Consolidated	
	Notes	**2018 £'000**	2017 £'000
Cash		**13,223**	16,093
Bank overdrafts		**—**	(5,903)
Cash and cash equivalents (including bank overdrafts)		**13,223**	10,190
Borrowings	21	**(73,821)**	(48,587)
Finance leases	23	**(2,007)**	(4,036)
Total net debt		**(62,605)**	(42,433)

Cash and cash equivalents, which are presented as a single class of assets on the face of the balance sheet, comprise cash at bank, short-term deposits and other short-term, highly liquid investments with maturity of three months or less.

Notes to the financial statements continued

for the year ended 31 March 2018

22 Net debt continued

	Other assets	Liabilities from financing activities			
	Cash/bank overdraft £'000	Finance leases due within 1 year £'000	Finance leases due after 1 year £'000	Bank loans £'000	Total £'000
Net debt at 1 April 2016	13,212	(3,271)	(3,680)	1,151	7,412
Cash flows	(3,022)	3,025	—	(50,000)	(49,997)
Payment of loan issue costs	—	—	—	720	720
Other non-cash movements	—	(1,696)	1,586	(458)	(568)
Net debt at 1 April 2017	10,190	(1,942)	(2,094)	(48,587)	(42,433)
Cash flows	3,033	2,099	—	(25,000)	(19,868)
Other non-cash movements	—	(1,879)	1,809	(234)	(304)
Net debt at 31 March 2018	**13,223**	**(1,722)**	**(285)**	**(73,821)**	**(62,605)**

23 Finance leases

	Consolidated	
	2018 £'000	2017 £'000
Finance lease liabilities:		
Minimum lease payments:		
– within 12 months	**1,722**	1,942
– in 1 to 5 years	**314**	2,463
	2,036	4,405
Future finance charges	**(29)**	(369)
Present value of finance lease liabilities	**2,007**	4,036
The present value of finance lease liabilities is as follows:		
– within 12 months	**1,722**	1,942
– in 1 to 5 years	**285**	2,094
Total	**2,007**	4,036

24 Provisions for other liabilities and charges

	Dilapidations £'000	Onerous leases £'000	Restructuring £'000	Total £'000
At 1 April 2017	—	2,339	—	2,339
Transferred from accruals	909	—	—	909
Established in the year	3,045	62	106	3,213
Unwind of discount	—	124	—	124
Utilised in the year	—	(368)	—	(368)
At 31 March 2018	**3,954**	**2,157**	**106**	**6,217**
Total provisions for other liabilities and charges 2018				
Included in current liabilities	—	365	106	471
Included in non-current liabilities	3,954	1,792	—	5,746
At 31 March 2018	**3,954**	**2,157**	**106**	**6,217**
Total provisions for other liabilities and charges 2017				
Included in current liabilities	—	377	—	377
Included in non-current liabilities	—	1,962	—	1,962
At 31 March 2017	—	2,339	—	2,339

The exit of the managed service arrangement with BT as noted on page 22 crystallised the Group's obligation for the costs of future dilapidations on our leased network sites. £2.4 million of the £3.0 million dilapidation provision established in the year relates to our leased network sites. The outflows associated with dilapidations will be incurred when returning properties to their original condition at the end of the lease period. There are currently no plans to vacate our leased sites within the next 12 months.

Provision has been made for the estimated fair value of unavoidable lease payments on unoccupied buildings. It is expected that these payments will arise over the next one to seven years.

24 Provisions for other liabilities and charges continued

The restructuring provision relates to redundancy costs associated with the closure of our outsourced Contact Centres. As at 31 March 2018, the employees impacted by the closure had been informed but redundancy compensation of £0.1 million remained payable to them.

25 Deferred taxation assets and liabilities

Deferred tax assets/(liabilities) are attributable to the following:

Consolidated	Assets 2018 £'000	Assets 2017 £'000	Liabilities 2018 £'000	Liabilities 2017 £'000	Net 2018 £'000	Net 2017 £'000
Property, plant and equipment	—	—	(4,320)	(3,602)	(4,320)	(3,602)
Other timing differences	423	438	—	—	423	438
Retirement benefit obligation	1,276	3,347	—	—	1,276	3,347
Intangible assets on acquisition	2,677	4,051	—	—	2,677	4,051
Asset-backed partnership	—	—	(3,696)	(3,896)	(3,696)	(3,896)
	4,376	7,836	(8,016)	(7,498)	(3,640)	338

Movements in net deferred tax assets/(liabilities) are as follows:

Consolidated	Notes	Property, plant and equipment £'000	Other timing differences £'000	Retirement benefit obligation £'000	Intangible assets arising on acquisition £'000	Asset-backed partnerships £'000	Total £'000
At 1 April 2016		(2,826)	719	2,871	4,766	(4,049)	1,481
Charged to the income statement	10	(776)	(159)	(1,109)	(715)	—	(2,759)
(Charged)/credited directly to equity and other comprehensive income		—	(122)	1,585	—	153	1,616
At 31 March 2017		(3,602)	438	3,347	4,051	(3,896)	338
(Charged)/credited to the income statement	10	(1,630)	(15)	(1,357)	(462)	200	(3,264)
Charged directly to equity and other comprehensive income		—	—	(715)	—	—	(715)
Transfer		912	—	—	(912)	—	—
At 31 March 2018		(4,320)	423	1,276	2,677	(3,696)	(3,640)

There are £Nil deferred tax assets in the Parent Company (2017: £Nil).

The analysis of deferred tax assets is as follows:

	2018 £'000	2017 £'000
Deferred tax assets to be recovered after more than 12 months	1,270	6,403
Deferred tax assets to be recovered within 12 months	3,106	1,433
	4,376	7,836

The analysis of deferred tax liabilities is as follows:

	2018 £'000	2017 £'000
Deferred tax liabilities to be recovered after more than 12 months	(7,788)	(6,971)
Deferred tax liabilities to be recovered within 12 months	(228)	(527)
	(8,016)	(7,498)

The major components of the deferred taxation asset not recognised are as follows:

	Not recognised 2018 £'000	Not recognised 2017 £'000
Losses	580	580

Deferred tax assets of £4.4 million (2017: £7.8 million) have been recognised in those subsidiary companies in which there is sufficient available evidence that suitable taxable profits will arise against which these assets are expected to reverse. There are additional deferred tax assets of £0.6 million (2017: £0.6 million) which have not been recognised, as there is insufficient evidence as to the generation of suitable profits against which these assets can be offset. The utilisation of these assets would reduce the Group's tax charge in future periods. Deferred tax has been provided at the rate at which it is expected to unwind.

Notes to the financial statements continued

for the year ended 31 March 2018

26 Called-up share capital

	2018 £'000	2017 £'000
Allotted, called up and fully paid		
516,603,910 (2017: 516,603,910) ordinary shares of 10 pence each	**51,660**	51,660

During the financial year, the Company did not purchase any of its own shares (2017: Nil); however, the Company funds Employee Share Trusts to meet its obligations under the Company's share schemes. During the year the Trusts purchased 624,959 (2017: 2,130,491) of the Company's ordinary shares through purchases on the London Stock Exchange for a total cash consideration of £450,000 (2017: £1,778,051) in order to meet the Company's obligations under the SIP and LTIP schemes. The total amount paid to acquire the shares, net of expenses and cash received for the exercise of share options, of £450,000 (2017: £1,778,051) has been deducted from retained earnings.

As of 31 March 2018, the total number of ordinary shares held by the Trusts to meet the Company's obligations under the share schemes was 5,309,601 (2017: 5,881,803).

27 Financial instruments and risk management

The Group's principal financial instruments during the year comprised bank loans, cash on short-term deposits, finance leases and forward foreign exchange contracts. The main purpose of these financial instruments is to finance the Group's operations and to minimise the impact of fluctuations in exchange rates on future cash flows. The Group has various other financial instruments such as short-term receivables and payables which arise directly from its operations.

The Group regularly reviews its exposure to interest, liquidity and foreign currency risk. Where appropriate the Group will take action, in accordance with a Board approved Treasury policy, to minimise the impact on the business of movements in interest rates and currency rates.

The Group only enters into derivative instruments with members of the banking group to ensure appropriate counterparty credit quality.

Liquidity risk

The Group keeps its short, medium and long-term funding requirements under constant review. Its policy is to have sufficient committed funds available to meet medium-term requirements, with flexibility and headroom to make minor acquisitions for cash if the opportunity should arise.

The Group's bank facilities comprise a multi-currency revolving credit facility of £180.0 million, provided by a group of five core relationship banks. The facility matures in December 2021. The Group considers that this facility will provide sufficient funding to meet the organic and inorganic investment needs of the business. In addition, short-term flexibility of funding is available under the £8.0 million overdraft facility in Pounds Sterling and $2.0 million overdraft facility in US Dollars provided by the Group's clearing bankers.

The net debt position of £42.4 million at the beginning of the financial year has increased during the year to £62.6 million. The Group generated positive cash flow after investing activities of £13.2 million for the year (2017: £15.6 million negative).

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. Notional interest is included for the period from the year end up to the contractual maturity date of the debt, calculated on the amount of debt drawn down at the year end.

	Less than one year £'000	One to three years £'000	Over three years £'000
At 31 March 2017			
Borrowings	1,225	2,450	52,144
Trade and other payables	103,424	—	—
Finance leases	1,942	2,094	—
Total	106,591	4,544	52,144
At 31 March 2018			
Borrowings	**1,665**	**3,330**	**76,249**
Trade and other payables	**82,406**	—	—
Finance leases	**1,722**	**285**	—
Total	**85,793**	**3,615**	**76,249**

27 Financial instruments and risk management continued

Foreign currency risk

Cash flow exposure

The Group's only major foreign currency risk arises due to the purchase of equipment invoiced in US Dollars. Whenever possible the Group resells this equipment in US Dollars. The remaining exposure is managed principally through the use of forward foreign exchange contracts in order to minimise the impact of fluctuations in exchange rates on future cash flows and gross margin.

The Group also has some Euro cash flows but these are not material on a net basis and are not hedged.

Net asset exposure

The Dollar-denominated trading described above results in a balance sheet exposure since debtor days are longer than creditor days. It is the Group's policy not to hedge this exposure.

Credit risk

Credit risk arises from cash and cash equivalents and derivative financial instruments, as well as credit exposures to business and retail customers.

Credit ratings of institutions which hold the Group's financial assets are regularly monitored to ensure they meet the minimum credit criteria set by the Board through the Group Treasury policy. At the year end all the institutions holding the Group's financial assets were rated A-/A- or higher by Standard and Poor's.

The credit quality of customers is assessed by taking into account their financial position, past experience and other factors. Individual risk limits are set and the utilisation of credit limits is monitored regularly.

The Group's exposure to credit risk is spread over a large number of customers. For an analysis of the quality of the ageing of the Group's trade receivables, see Note 19 for further disclosures.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. The Group does not hold any collateral as security.

Currency and interest rate risk profile of financial assets and financial liabilities

Financial assets

The Group had net financial assets of £13.2 million at the year end (2017: £10.2 million), comprising cash on overnight money market deposits and cash at bank. This attracts floating rates of interest.

The currency profile of the Group's financial assets at 31 March 2018 and 31 March 2017 was:

	2018 £'000	2017 £'000
Currency		
Sterling	11,314	4,705
US Dollar	1,677	5,130
Euro	232	355
Total	13,223	10,190

Foreign currency cash balances are held on a short-term basis to fund cash flow requirements in these currencies. All trade receivable balances bear no interest and are held in Sterling with the exception of a combined equivalent amount of £0.1 million held in Euros and US Dollars.

At the year end £1.3 million (2017: £1.3 million) of cash collateral was held by Barclays in respect of a bank guarantee given under Ofcom's 'Funds for Liabilities' regulations.

Financial liabilities

The currency and interest rate risk profile of the Group's financial borrowings at 31 March 2018 and 31 March 2017 was:

	2018			2017		
	Floating £'000	Fixed £'000	Total £'000	Floating £'000	Fixed £'000	Total £'000
Sterling	75,000	—	75,000	50,000	—	50,000

Undrawn committed borrowing facilities at the year end were £105.0 million (2017: £130.0 million).

Interest on amounts drawn under the committed borrowing facility is based on the relevant LIBOR plus margin. All trade payable balances bear no interest and are held in Sterling with the exception of an equivalent of £2.9 million which is held in US Dollars. There is no currency risk associated with these balances.

Notes to the financial statements continued

for the year ended 31 March 2018

27 Financial instruments and risk management continued

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern, support the growth of the business and maintain an optimal capital structure to reduce the cost of capital.

Consistent with others in the industry, the Group monitors capital on the basis of its gearing ratio. This ratio is calculated as net debt divided by total capital. For the definition and reconciliation of net debt to the closest equivalent IFRS measure see the glossary on page 121.

IFRS 7 requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

> quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);

> inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2); and

> inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

All of the Group's financial instruments fall into hierarchy level 2.

Total capital is shown in the table below and is calculated as 'equity' as shown in the Consolidated balance sheet plus net debt.

	2018 £'000	2017 £'000
Net debt	62,605	42,433
Total equity	101,193	99,888
Total capital	163,798	142,321

Under the Group's £180.0 million revolving credit facility the Group is required to comply annually with certain financial and non-financial covenants. The Group is required to maintain a minimum interest cover ratio and a maximum net debt to EBITDA ratio. Both financial covenants were tested and complied with throughout the year and at the year end. The Board monitors both covenant compliance and net debt performance on a regular basis.

28 Financial commitments

Authorised future capital expenditure and financial investment amounted to:

	Consolidated	
	2018 £'000	2017 £'000
Property, plant and equipment	5,767	3,110
Intangible assets	2,210	391
Total	7,977	3,501

The Group as lessee

The future aggregate minimum lease rental commitments under non-cancellable operating leases were as follows:

	Consolidated	
	2018 £'000	2017 £'000
Leasehold buildings:		
– within 12 months	3,094	3,321
– in 1 to 5 years	7,375	8,130
– after 5 years	3,080	4,550
Total	13,549	16,001
Plant and equipment:		
– within 12 months	381	409
– in 1 to 5 years	479	866
Total	860	1,275

None of the Group's lease arrangements include any contingent rent payments and there are no renewal or purchase options or escalation clauses. There are also no restrictions imposed by the Group's lease arrangements.

29 Retirement benefit obligation – consolidated

Defined benefit schemes

The Group operates two defined benefit schemes, the Kingston Communications Pension Scheme ('Main scheme') and the Kingston Communications (Data) Pension Scheme ('Data scheme'). Both schemes are closed to both new members and future benefit accrual.

The defined benefit schemes are operated in the UK under the same regulatory frameworks. Both of the schemes are final salary pension schemes, which provide benefits to members in the form of a guaranteed level of pension payable for life at retirement. The level of benefits provided depends on the members' length of service and their final pensionable salary at the date they left the scheme.

In both cases, the schemes are funded and the assets of the schemes are held separately from the assets of the Group in Trustee administered funds.

All of the benefit payments are made from these Trustee administered funds. Scheme assets held in trusts are governed by local regulations and practice, as is the nature of the relationship between the Group and the Trustees (or equivalent) and their composition. The schemes are also offered additional security and funded, in part, via asset-backed partnerships. Details on this can be found below.

Responsibility for governance of the schemes – including investment decisions and contribution schedules – lies jointly with the Group and the Trustees. The Trustees must be composed of representatives of the Group and scheme participants in accordance with each scheme's individual Rules.

Funding

The pension schemes are subject to a full actuarial valuation every three years using assumptions agreed between the Trustees and the Group. The purpose of this valuation is to design funding plans to ensure that the pension schemes have sufficient funds available to meet future benefit payments. The most recent valuations were carried out by independent professionally qualified actuaries as at 31 March 2016 and resulted in a funding deficit of £25.4 million (31 March 2013: £46.3m) for the main scheme and £9.4 million (31 March 2013: £12.9 million) for the data scheme.

As a result of the funding valuations, the Group and the Trustees agreed to put in place plans to eliminate the deficits over 6 years (main scheme) and 4 years (data schemes).

Contributions agreed as part of these plans were as follows:

> Main scheme deficit repair payments from 1 April 2016 to 30 April 2022 of £4.5 million per annum to be paid in equal monthly instalments, increasing in line with CPI inflation from 1 April 2018.

> Data scheme deficit repair payments from 1 April 2016 to 30 April 2020 of £2.2 million per annum to be paid in equal monthly instalments, increasing in line with CPI inflation from 1 April 2018.

The deficit repair payments are in addition to contributions made to the schemes via the Asset-backed partnership (see below).

Taking into account deficit repair payments and contributions via the asset-backed partnership the expected total contributions for the year ended 31 March 2019 are £7.1 million (main scheme) and £2.7 million (data scheme).

Asset-backed partnership

On 31 March 2013, the Group reached an agreement with the Trustees to provide the Group with an efficient mechanism of funding the schemes' deficit positions.

The Group established a general partner, KCOM (General Partner) Limited, and a partnership, KCOM Central Asset Reserve Limited Partnership ('the Partnership'), which are both consolidated within these financial statements. The Group takes advantage of the exception conferred by Regulation 7 of the Partnership (Accounts) Regulations 2008 and has therefore not appended the accounts of the Partnership to these accounts. Separate accounts for the Partnership are not required to be filed at Companies House. The Group provided sufficient capital to the Partnership to enable it to procure freehold property assets with a market value of £12.6 million owned by fellow Group subsidiaries. These properties were immediately leased back and continue to be operated by those Group companies and not by the Partnership. The Group retains control over these properties including the flexibility of substituting the freehold property assets with other assets. As partners in the Partnership, the pension schemes are entitled to an annual income distribution of £1.1 million, rising in line with the Consumer Price Index (CPI) over a potential of 15 years.

On 24 March 2014, the Group reached an agreement with the Trustees to provide further funding of the schemes' current deficit position through the Partnership.

As part of this agreement, a loan note of £20.0 million was secured over the Hull & East Yorkshire network asset. The security does not offer the Trustees any 'normal' rights of enforcement over the assets. Instead it provides first priority payment of any value that would be realised from the Hull & East Yorkshire network on an insolvency event.

As partners in the Partnership, the pension schemes are entitled an annual income distribution of £1.6 million, rising in line with the Consumer Price Index (CPI) (capped at 5%) over a potential of 15 years.

Under IAS 19, the investment held by the pension schemes in the Partnership does not represent a plan asset for the purpose of the Group's consolidated accounts. The distribution of the Partnership's profits to the pension schemes is reflected as pension contributions in these Group accounts on a cash basis.

Notes to the financial statements continued

for the year ended 31 March 2018

29 Retirement benefit obligation – consolidated continued

Risk

The cost of the schemes to the Group depend upon a number of assumptions about future events. Future contributions may be higher (or lower) than those currently agreed if the assumptions are not borne out in practice or if different assumptions are agreed in the future.

Specific risks include:

Changes in future expectations of price inflation: The scheme's benefit obligations are linked to inflation and higher inflation will lead to higher liabilities. Hence, an increase in inflation will increase the deficit. This is offset in part by the Trustee's liability matching investment strategy as detailed below.

Changes in the discount rate used to value pension liabilities: A lower discount rate will lead to a higher present value being placed on future pension payments. Hence, a reduction in discount rate will increase the deficit. This is offset in part by the Trustee's liability matching scheme detailed below.

Unanticipated increase in life expectancy leading to an increase in the scheme's liabilities: An increase in life expectancy would mean pensions are expected to be paid for a longer period, so increasing the liability and the scheme's deficit. This is offset in part by the scheme applying a Life Expectancy Adjustment Factor, whereby future pensions coming into payment are adjusted to allow for increases in life expectancy.

Consideration is given each year as to whether pensions should be included specifically in the risk register and within our reported risks on pages 29 and 32.

Balance sheet amounts

The amounts recognised in the balance sheet (the 'accounting valuation') and the movements in the net defined obligation over the year are calculated in accordance with IAS 19 and detailed below.

Differences between the funding valuation and the accounting valuation are mainly due to the use of different valuation assumptions and changes in market conditions between the two valuation dates of 31 March 2016 and 31 March 2018.

For funding valuation purposes the liabilities are determined based on assumptions used by the Trustees following consultation with the Group and scheme actuaries. In the financial statements the liabilities are determined in accordance with IAS 19.

As a result of the difference in the valuation methods used, and also possible differences in the dates of the respective valuations, it is possible, and not unusual, for there to be large differences in the two valuations. To the extent that the accounting measure could result in a surplus whilst the actuarial valuation could result in a deficit requiring additional contributions to be made.

The IAS 19 position, even if in surplus in the future, has no bearing on cash requirements to the schemes and the Company remains legally obliged to pay contributions to the schemes.

Although not in a surplus at the year end the Directors consider that a future surplus would be recoverable and therefore there are no additional liabilities to consider as a result of IFRIC 14.

29 Retirement benefit obligation – consolidated continued

Balance sheet amounts continued

	Main scheme			Data scheme			Combined schemes		
	Present value of obligation £'000	Fair value of plan assets £'000	Total £'000	Present value of obligation £'000	Fair value of plan assets £'000	Total £'000	Present value of obligation £'000	Fair value of plan assets £'000	Total £'000
At 1 April 2016	**193,329**	**(184,249)**	**9,080**	**34,209**	**(28,939)**	**5,270**	**227,538**	**(213,188)**	**14,350**
Service cost	—	—	—	—	—	—	—	—	—
Administrative expenses	—	655	655	—	—	—	—	655	655
Interest expense/(income)	6,517	(6,290)	227	1,168	(1,020)	148	7,685	(7,310)	375
Total amount recognised in profit or loss	**6,517**	**(5,635)**	**882**	**1,168**	**(1,020)**	**148**	**7,685**	**(6,655)**	**1,030**
Remeasurements									
Return on plan assets, excluding amounts included in interest	—	(30,384)	(30,384)	—	(3,288)	(3,288)	—	(33,672)	(33,672)
Loss from change in financial assumptions	41,329	—	41,329	7,746	—	7,746	49,075	—	49,075
Gain arising from changes in demographic assumptions	(2,346)	—	(2,346)	(797)	—	(797)	(3,143)	—	(3,143)
Experience gains	(144)	—	(144)	(81)	—	(81)	(225)	—	(225)
Total amount recognised in other comprehensive income	**38,839**	**(30,384)**	**8,455**	**6,868**	**(3,288)**	**3,580**	**45,707**	**(33,672)**	**12,035**
Employer contributions:									
Contributions via asset-backed partnership	—	(2,385)	(2,385)	—	(326)	(326)	—	(2,711)	(2,711)
Deficit repair payments	—	(3,342)	(3,342)	—	(1,671)	(1,671)	—	(5,013)	(5,013)
Benefit payments	(8,962)	8,962	—	(739)	739	—	(9,701)	9,701	—
At 31 March 2017	**229,723**	**(217,033)**	**12,690**	**41,506**	**(34,505)**	**7,001**	**271,229**	**(251,538)**	**19,691**

	Main Scheme			Data Scheme			Combined schemes		
	Present value of obligation £'000	Fair value of plan assets £'000	Total £'000	Present value of obligation £'000	Fair value of plan assets £'000	Total £'000	Present value of obligation £'000	Fair value of plan assets £'000	Total £'000
At 31 March 2017	**229,723**	**(217,033)**	**12,690**	**41,506**	**(34,505)**	**7,001**	**271,229**	**(251,538)**	**19,691**
Service cost	—	—	—	—	—	—	—	—	—
Administrative expenses	—	711	711	—	389	389	—	1,100	1,100
Interest expense/(income)	5,607	(5,366)	241	1,018	(870)	148	6,625	(6,236)	389
Total amount recognised in profit or loss	**5,607**	**(4,655)**	**952**	**1,018**	**(481)**	**537**	**6,625**	**(5,136)**	**1,489**
Remeasurements									
Return on plan assets, excluding amounts included in interest	—	(965)	(965)	—	251	251	—	(714)	(714)
Gains from change in financial assumptions	(1,687)	—	(1,687)	(147)	—	(147)	(1,834)	—	(1,834)
Gain arising from changes in demographic assumptions	(1,377)	—	(1,377)	(278)	—	(278)	(1,655)	—	(1,655)
Experience gains	—	—	—	—	—	—	—	—	—
Total amount recognised in other comprehensive income	**(3,064)**	**(965)**	**(4,029)**	**(425)**	**251**	**(174)**	**(3,489)**	**(714)**	**(4,203)**
Employer contributions:									
Contributions via asset-backed partnership	—	(2,398)	(2,398)	—	(328)	(328)	—	(2,726)	(2,726)
Deficit repair payments	—	(4,496)	(4,496)	—	(2,248)	(2,248)	—	(6,744)	(6,744)
Benefit payments	(10,984)	10,984	—	(1,597)	1,597	—	(12,581)	12,581	—
At 31 March 2018	**221,282**	**(218,563)**	**2,719**	**40,502**	**(35,714)**	**4,788**	**261,784**	**(254,277)**	**7,507**

Notes to the financial statements continued

for the year ended 31 March 2018

29 Retirement benefit obligation – consolidated continued

Significant estimates: IAS 19 assumptions and sensitivity

The significant IAS 19 assumptions were as follows:

	2018		2017	
	Main scheme	**Data scheme**	Main scheme	Data scheme
RPI inflation	**3.10%**	**3.10%**	3.15%	3.15%
CPI inflation	**2.10%**	**2.10%**	2.15%	2.15%
Rate of increase to pensions in payment	**1.93%**	**3.78%**	1.97%	3.78%
Discount rate for scheme liabilities	**2.50%**	**2.50%**	2.50%	2.50%

Assumptions regarding future mortality are set based on actuarial advice in accordance with published statistics.

The assumptions translate into an average life expectancy in years for a pensioner retiring at age 65 as follows:

	2018		2017	
	Main scheme	**Data scheme**	Main scheme	Data scheme
Retiring at the end of the reporting year:				
Male	**22**	**23**	22	23
Female	**23**	**25**	24	25
Retiring 20 years after the end of the reporting year:				
Male	**23**	**24**	23	24
Female	**25**	**26**	25	26

The sensitivity of the defined benefit obligation to changes in the significant weighted principal assumptions is:

	Increase in assumption				Decrease in assumption			
	2018		2017		2018		2017	
	Main scheme £'000	**Data scheme £'000**	Main scheme £'000	Data scheme £'000	**Main scheme £'000**	**Data scheme £'000**	Main scheme £'000	Data scheme £'000
Sensitivity to 0.1% change to:								
Discount rate	**(1.7%)**	**(1.7%)**	(1.7%)	(1.9%)	**1.8%**	**2.0%**	1.7%	1.9%
RPI Inflation	**1.6%**	**1.0%**	1.6%	1.0%	**(1.6%)**	**(0.7%)**	(1.5%)	(0.7%)
Sensitivity to 1 year change in life expectancy	**3.0%**	**3.5%**	3.0%	3.4%	**(3.0%)**	**(3.5%)**	(3.0%)	(3.4%)

The above sensitivity analyses are based on a change in a single assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and the changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting year) has been applied as when calculating the defined benefit liability recognised on the balance sheet.

The methods used to determine the liabilities and types of assumptions used in preparing the disclosed results and sensitivity analysis has not changed compared to the prior year.

29 Retirement benefit obligation – consolidated continued

Balance sheet amounts

The major categories of plan assets are as follows:

	2018				2017			
	Main scheme £'000	Data scheme £'000	Total £'000	%	Main scheme £'000	Data scheme £'000	Total £'000	%
Index linked gilts	8,340	—	8,340	3%	8,418	—	8,418	3%
Leveraged index linked gilts	49,958	13,407	63,365	25%	54,913	6,587	61,500	24%
Inflation swap fund	10,958	—	10,958	5%	11,522	—	11,522	5%
Liability matching funds (unquoted)	69,256	13,407	82,663	33%	74,853	6,587	81,440	32%
Equities (quoted)	31,064	6,811	37,875	15%	38,019	14,688	52,707	21%
Property (unquoted)	—	1,135	1,135	0%	—	1,827	1,827	1%
Diversified growth fund (unquoted)	42,547	5,607	48,154	19%	46,890	9,861	56,751	23%
Corporate bonds (quoted)	55,861	8,053	63,914	25%	42,608	—	42,608	17%
Hedge funds (unquoted)	15,257	—	15,257	6%	38	—	38	0%
Cash and other (quoted)	4,578	701	5,279	2%	14,625	1,542	16,167	6%
Total	218,563	35,714	254,277	100%	217,033	34,505	251,538	100%

Liability Matching Funds

Part of the investment objective of the Schemes is to minimise fluctuations in the Schemes' funding levels due to relative changes in the value of the Schemes' assets and liabilities. This is primarily achieved through 'liability matching funds', whose main goal is to align movements in the value of assets with movements in the schemes' liabilities arising from changes in market conditions. The schemes have hedging that covers a proportion of the interest rate movements and inflation movements, as measured on the Trustees' funding assumptions which use a discount rate derived from gilt yields.

Liability matching funds primarily involve the use of government and corporate bonds. Derivatives such as interest rate and inflation swaps may also be used. There are no annuities or longevity swaps currently held by the Schemes.

The value of the liability matching fund assets are determined based on the latest market bid price for the underlying investments, which are traded daily/weekly on liquid markets.

Diversified Growth Funds

The schemes employ diversified growth funds to reduce volatility in the Schemes' asset values (compared to traditional equity investments), whilst maintaining an appropriate level of return. These funds typically invest in a range of public and private market assets, including equities, bonds, commodities, property and other assets.

Unquoted securities, consisting of pooled investment vehicles, are stated at fair value at year end as provided by the investment managers. Pooled investment vehicles are stated at bid price for funds with bid/offer spreads, or single price where there are no bid/offer spreads.

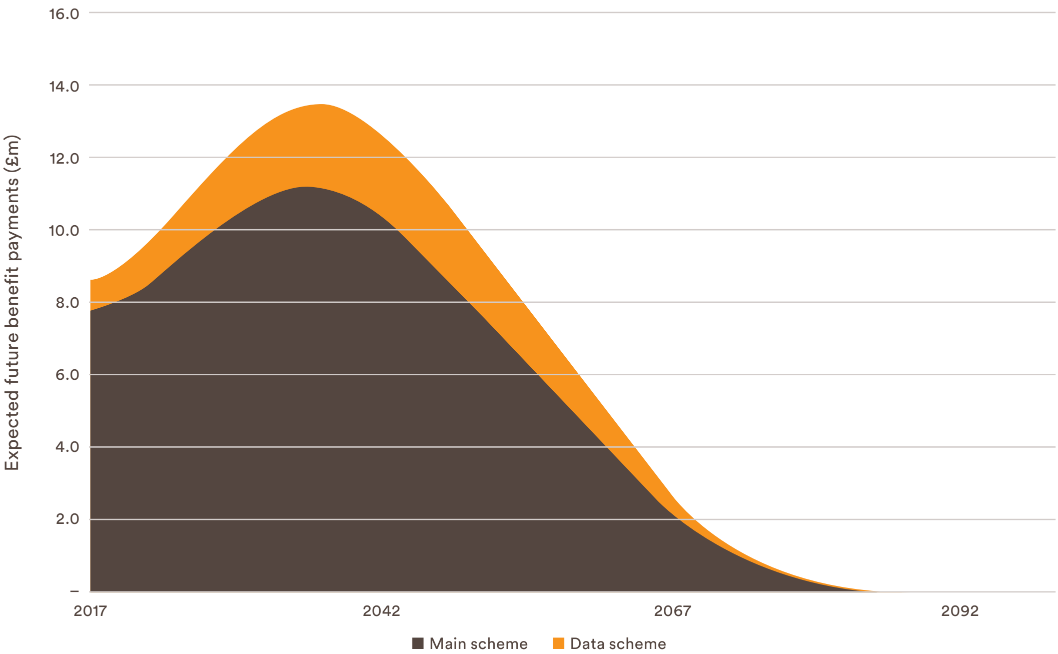
Notes to the financial statements continued

for the year ended 31 March 2018

29 Retirement benefit obligation – consolidated continued

Future benefit payments

The graph below shows the estimated undiscounted benefit payments expected to be paid from the funds over their lives, derived from the data used in the triennial valuations of the funds as at 31 March 2016:



Parent company

KCH (Holdings) Limited, a wholly owned subsidiary of the Parent, is responsible for all obligations and liabilities of the schemes. An equivalent liability has been provided in the accounts of KCH (Holdings) Limited.

The Parent Company provides a guarantee to both defined benefit schemes, whereby if KCH (Holdings) Limited is unable to meet its obligations to the schemes, such obligations would be met by the Parent Company. No liability has been recognised in respect of the guarantee at 31 March 2018 (2017: £Nil).

Defined contribution schemes

The Group operates defined contribution schemes, which are open to all eligible employees. Contributions charged to the income statement in respect of defined contribution schemes amounted to £3.0 million (2017: £3.6 million).

30 Other commitments and contingent liabilities

Contingent liabilities existed at 31 March 2018 and at 31 March 2017 in respect of guarantees given by the Parent company on behalf of subsidiary undertakings, together with contingencies arising in the normal course of the Group's business in respect of overdraft facilities. None of these guarantees are considered material in the context of the net assets of the Group.

31 Related party transactions

Remuneration of key management personnel

The remuneration of the Directors who are the key management personnel of KCOM Group PLC, is provided in the audited part of the Directors' Remuneration report on pages 58 to 74 and forms part of these financial statements.

Intra-Group transactions

Amounts payable by the Company to subsidiaries totalled £0.5 million (2017: £0.5 million) as at 31 March 2018.

Glossary

Alternative Performance Measures

In response to the Guidelines on Alternative Performance Measures (APMs) issued by the European Securities and Markets Authority (ESMA), we have provided additional information on the APMs used by the Group. The Directors use the APMs listed below as they are critical to understanding the financial performance of the Group. As they are not defined by IFRS, they may not be directly comparable with other companies who use similar measures.

Measures	Closest equivalent IFRS measure	Definition and purpose	Reconciliation to closest equivalent IFRS measure
Profit measures			
EBITDA before exceptional items ('EBITDA')	Profit before tax	EBITDA before exceptional items is the key measure used by management to monitor the underlying performance of the Group. EBITDA before exceptional items is also reported to the Board, is incorporated in banking covenants and is an important measure for setting remuneration. EBITDA before exceptional items is important to the users of the accounts as it assists with comparing performance from previous periods. The items classified as exceptional items are described in Note 7. EBITDA before exceptional items is defined as 'profit before tax' before share of profit before associates, finance costs, amortisation, depreciation and exceptional items.	Profit before tax as quoted in the consolidated income statement (£34.0 million), add back finance costs (£2.4 million) as quoted on the consolidated income statement, less share of profit of associate (£0.0 million) as quoted on the consolidated income statement, add back depreciation and amortisation (£32.6 million) as quoted on the consolidated cash flow statement, less exceptional credit (£0.7 million) as quoted in Note 7.
Contribution	Profit before tax	An equivalent measure to 'EBITDA before exceptional items' for each of the Group's market segments. The metric is used by management and the Board to compare performance across segments.	See above for reconciliation of EBITDA to profit before tax. The split of EBITDA by market segment can be seen in Note 4.
Adjusted basic earnings per share	Basic earnings per share	This provides additional information regarding earnings per share attributable to the underlying activities of the business. Basic earnings per share based upon profit after tax adjusted for the impact of exceptional items.	A reconciliation of this measure is provided in Note 12 of the financial statements.
Adjusted diluted earnings per share	Diluted earnings per share	This provides additional information regarding diluted earnings per share attributable to the underlying activities of the business. Diluted earnings per share based upon profit after tax adjusted for the impact of exceptional items.	A reconciliation of this measure is provided in Note 12 of the financial statements.

Glossary continued

Alternative Performance Measures continued

Measures	Closest equivalent IFRS measure	Definition and purpose	Reconciliation to closest equivalent IFRS measure
Cash flows and net debt measures			
Net debt	Cash and cash equivalents, bank overdrafts, finance leases (current and non-current) and bank loans	Net debt is important as it allows management to assess available funds by calculating how much headroom there is within the Group's borrowing facilities. It is used in the monitoring, reporting and planning of cash flows, and for the purpose of monitoring compliance with the terms of the Group's facilities. Net debt to EBITDA is a key ratio used by external stakeholders. Net debt is cash and cash equivalents, bank overdrafts, finance leases (current and non-current) and bank loans.	A reconciliation of this measure is provided in Note 22 of the financial statements.
Cash capital expenditure	Net cash used in investing activities	A proportion of our capital expenditure is obtained under financing arrangements therefore, compared to capital additions, this measure allows management to monitor, report and plan the cash flows relating to capital projects. This measure is important to the users of the accounts as it provides the outflow of cash expenditure in the current year relating to assets purchased in the current and prior years. Cash capital expenditure is net cash used in investing activities before proceeds from sale of property, plant and equipment plus capital element of finance lease repayments.	Reported in the consolidated cash flow statement: Net cash used in investing activities (£41.3 million) add back proceeds from sale of property, plant and equipment (£0.5 million) plus capital element of finance lease repayments (£2.1 million).
Underlying working capital movement	No direct equivalent	This measure is used by management as it provides a more appropriate reflection of the working capital movement by excluding certain movements relating to exceptional items. Underlying working capital movement is working capital movement less working capital movement due to exceptional items.	Increase in working capital quoted in consolidated cash flow statement (£4.2 million) less increase due to exceptional items quoted in Note 7 (£1.8 million).

Five year summary of consolidated figures

as at 31 March 2018

	2018 £'000	2017 £'000	2016 £'000	2015 £'000	2014 £'000
Income statement (total operations)					
Revenue	**301,898**	331,303	349,222	347,984	370,697
EBITDA before exceptional items	**68,270**	67,645	74,937	74,304	75,291
Group operating profit before exceptional items	**35,713**	40,737	50,898	57,193	55,019
Profit after taxation before exceptional items[1]	**26,755**	32,743	30,248	47,332	38,317
Profit after taxation (reported)	**27,478**	24,762	71,134	12,544	38,770
Balance sheet					
Non-current assets	**215,538**	211,285	198,006	236,678	247,208
Current assets (excluding cash)	**57,281**	71,481	66,918	81,353	76,782
Current liabilities (excluding finance leases and overdrafts)	**(87,752)**	(111,294)	(132,443)	(118,754)	(130,210)
Net (debt)/funds (including finance leases)	**(62,605)**	(42,433)	7,412	(99,348)	(74,976)
Provisions and other non-current liabilities (excluding finance leases and bank loans)	**(21,269)**	(29,151)	(23,626)	(36,050)	(33,651)
Total equity	**101,193**	99,888	116,267	63,879	85,153
Movement in debt					
Net cash flow from:					
– operating activities	**54,498**	28,571	80,373	50,779	71,266
– capital expenditure	**(41,836)**	(44,195)	(28,426)	(32,022)	(27,912)
– interest	**(1,601)**	(1,257)	(2,794)	(5,574)	(4,436)
– equity dividends paid	**(30,996)**	(30,686)	(28,672)	(26,057)	(23,764)
– other	**(237)**	(2,278)	86,279	(11,498)	(1,912)
(Increase)/decrease in net debt	**(20,172)**	(49,845)	106,760	(24,372)	13,242
Ratios and other key information					
Average number of employees	**1,552**	1,712	1,706	1,776	1,907
EBITDA before exceptional items to revenue (%)	**22.6**	20.4	21.5	21.4	20.3
Group operating profit before exceptional items to revenue (%)	**11.8**	12.3	14.6	16.4	14.8
Basic earnings per share (pence)	**5.38**	4.85	13.96	2.47	7.64
Dividend per share relating to the financial year (pence)	**6.00**	6.00	5.91	5.37	4.88

1. Including the tax impact of exceptional items.

Shareholder information

Analysis of ordinary shareholders
(at 31 March 2018 by category)

	Number of holders	Number of shares	% of total shares
Private shareholders	49,246	46,913,920	9.08
Deceased accounts	638	413,882	0.08
Investment trusts	6	112,847	0.02
Nominee companies	851	384,970,627	74.52
Limited companies	63	498,278	0.10
Bank & bank nominees	9	83,479,303	16.16
Other institutions	14	215,053	0.04
Total	**50,827**	**516,603,910**	**100.00**

Financial calendar

Annual General Meeting (AGM)	20 July 2018
Half year results announcement (provisional)	27 November 2018
Final results announcement (provisional)	4 June 2019

Annual General Meeting 2018
This year's AGM will be held at KCOM Stadium, Hull HU3 6HU, on Friday 20 July 2018. The meeting will start at 1pm and registration will be open from 12pm.

Information relating to beneficial owners of shares with 'information rights'
Please note that beneficial owners of shares who have been nominated by the registered holder of those shares to receive information rights under Section 146 of the Companies Act 2006 are required to direct all communications to the registered holder of their shares rather than to the Group's registrar, Link Asset Services, or to KCOM Group PLC directly.

Boiler room scams
'Boiler rooms' are high pressure sales firms, often based overseas, that target investors by illegally offering them non-tradable, overpriced or even non-existent shares. Boiler rooms usually target existing shareholders by legally obtaining a company's share register. This is a publicly available document, so it is relatively easy for someone to access your name and address. They then look to other sources of information, such as directory enquiry services, to obtain your phone number.

If you are contacted:

> Make sure you get the correct name of the person and organisation and make a record of any other information they give you, such as their telephone number, address or web address;

> If you receive telephone calls, emails or letters purporting to be from KCOM or from companies endorsed by us and you are unsure if they are legitimate, please contact our shareholder helpline for clarification on 01482 602711;

> Check the caller is properly authorised by the Financial Conduct Authority (FCA) before getting involved by visiting www.fca.org.uk/register/;

> If the caller persists, hang up; and

> Report the matter to the FCA.

Details of any share dealing facilities that KCOM endorses will be included in company mailings.

Company information
Registered office
KCOM Group PLC
37 Carr Lane
Hull HU1 3RE

Registered in England and Wales

Company number
2150618

Advisors
Independent auditors
PricewaterhouseCoopers LLP
Chartered Accountants
and Statutory Auditors
Embankment Place
London WC2N 6RH

Registrar
Link Asset Services
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Email: shareholder.enquiries@linkgroup.co.uk
Tel: 0371 664 0300 (If calling from outside the United Kingdom call +44 371 664 0300) (Calls are charged at the standard geographical rate and will vary by provider. Calls outside the United Kingdom will be charged at the applicable international rate; lines are open between 9.00am–5.30pm Monday–Friday excluding public bank holidays in England and Wales)
Website: www.kcom-shares.com

Financial advisors
Investec Bank plc
2 Gresham Street
London EC2V 7QP

Peel Hunt
Moor House
120 London Road
London EC2Y 5ET

Keep in touch

Investor relations
KCOM Group PLC
37 Carr Lane
Hull HU1 3RE
Email: investor.relations@kcom.com
Tel: 01482 602711
Website: www.kcomplc.com

Corporate responsibility
KCOM Group PLC
37 Carr Lane
Hull HU1 3RE
Email: kathy.smith@kcom.com
Tel: 01482 602100

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