KCOM Preliminary results 2017

6 June 2017

Highlights

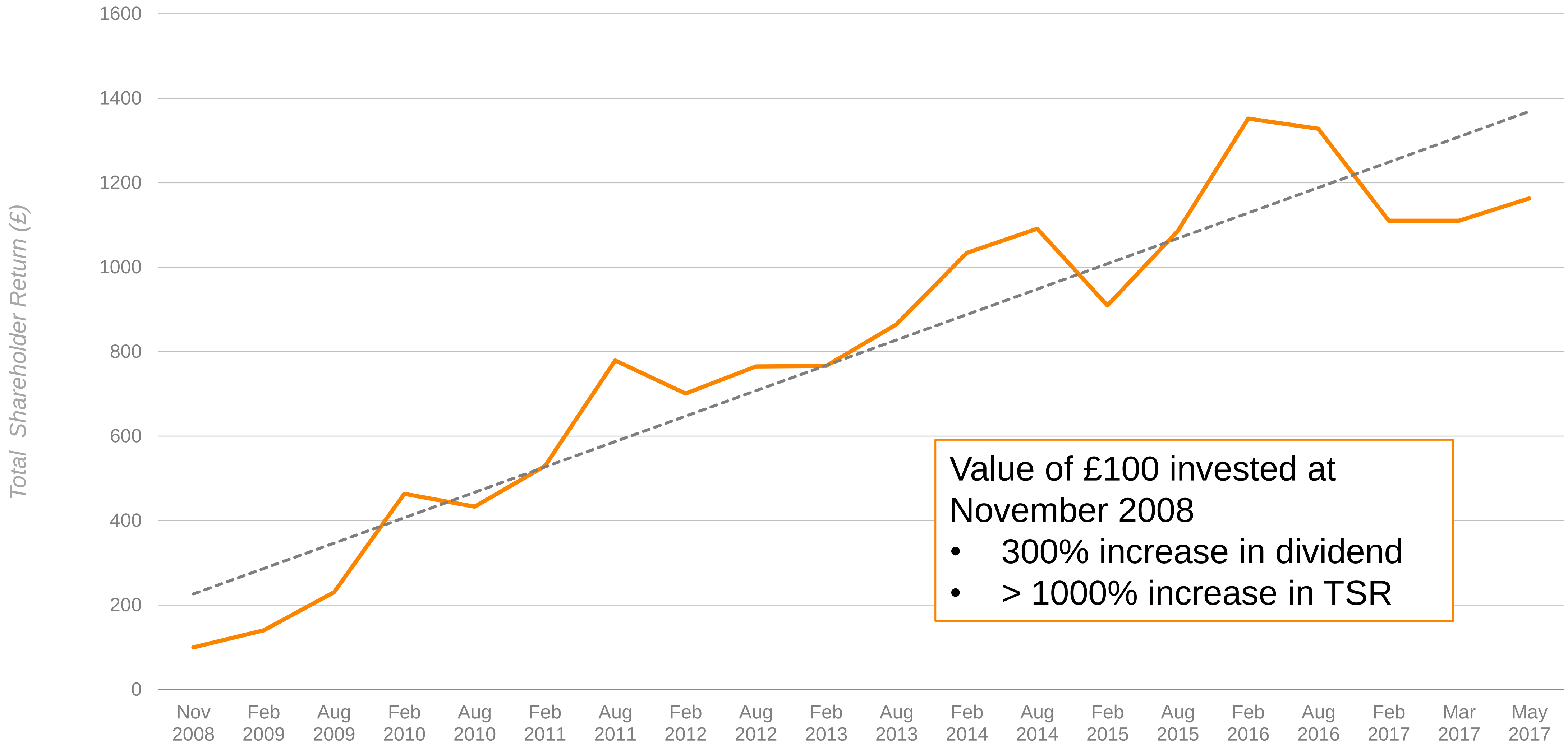
- Results in line with expectations, reduction from last year largely due to continuing decline in legacy business and additional cost of the national fibre network outsource
- Continued investment in fibre network in Hull & East Yorkshire ahead of schedule, supporting a 3% increase in consumer sales
- Enterprise revenue grown by 5%, with top five customers growing by 16%
- Continued focus on optimising cost base with year-on-year reduction in indirect costs
- Strengthened management team and organisation, aligned to deliver our medium term strategy
- Strong cash management with favourable year-on-year underlying working capital movement
- Recommended final dividend of 4.00p to make 6.00p per share for the full year

Creating shareholder value

Income and capital growth

Hull & East Yorkshire	Enterprise	National Network Services
Communications services for the region's consumers and businesses	IP-based communications & collaboration services for UK enterprises	Connectivity-based services for organisations nationwide
Investment focus	Investment light / customer funded	Limited investment
Income	Growth	Manage for value

Focused on total shareholder returns



Value of £100 invested at November 2008

- 300% increase in dividend
- > 1000% increase in TSR

Financial performance

Jane Aikman

Summary financial results

	FY17 £m	FY16 £m	% Change
Revenue	**331.3**	**349.2**	**(5)%**
EBITDA	**67.6**	**74.9**	**(10)%**
EBITDA %	*20%*	*21%*	
Profit before tax	**38.5**	**47.9**	**(20)%**
Adjusted basic EPS (pence)*	6.10	7.54	(19)%
Exceptional items	(8.0)	40.9	
Cash capital expenditure	(47.2)	(31.3)	
Net (debt)/funds	(42.4)	7.4	
Full year dividend per share (pence)	**6.00**	**5.91**	**2%**

All amounts are before exceptional items

** Adjusted basic EPS is basic EPS adjusted for post tax impact of exceptional items*

- Group performance lower than last year:
  - shift away from commodity business
  - additional cost of the national fibre network outsource
  - cost overrun with one Enterprise customer in the project build phase
- Business transformation continues with headcount reduction and advisory costs reflected in exceptional items
- Increased capital investment, including successful ongoing fibre deployment, driving higher D&A
- Strong net debt management with favourable underlying working capital movement
- 6.00p full year dividend recommended

Segmental performance

- We have refined our segments to align with the way the business is run and how financial performance is measured

	HEY		Enterprise		National Network Services		Central		Group	
	FY17 £m	FY16 £m	FY17 £m	FY16 £m	FY17 £m	FY16 £m	FY17 £m	FY16 £m	FY17 £m	FY16 £m
Revenue	**102.3**	**104.5**	**91.0**	**86.7**	**141.8**	**163.2**	**(3.7)**	**(5.2)**	**331.3**	**349.2**
Gross Margin	**78.5**	**79.2**	**25.6**	**28.6**	**41.0**	**44.9**			**145.1**	**152.8**
%	*77%*	*76%*	*28%*	*33%*	*29%*	*28%*			*44%*	*44%*
Indirect Costs	(18.0)	(19.5)	(21.1)	(20.4)	(25.0)	(25.6)	(11.5)	(11.5)	(75.7)	(76.9)
Share based payments	-	-	-	-	-	-	(1.8)	(0.9)	(1.8)	(0.9)
Contribution / EBITDA	**60.4**	**59.8**	**4.5**	**8.2**	**16.0**	**19.3**	**(13.2)**	**(12.4)**	**67.6**	**74.9**
%	*59%*	*57%*	*5%*	*9%*	*11%*	*12%*			*20%*	*22%*

- Indirect costs have reduced by £1.2m (2%) from last year due to continued focus on the cost base. 54 head reduction in H2 as we continue to right-size the business
- Central costs stable year-on-year

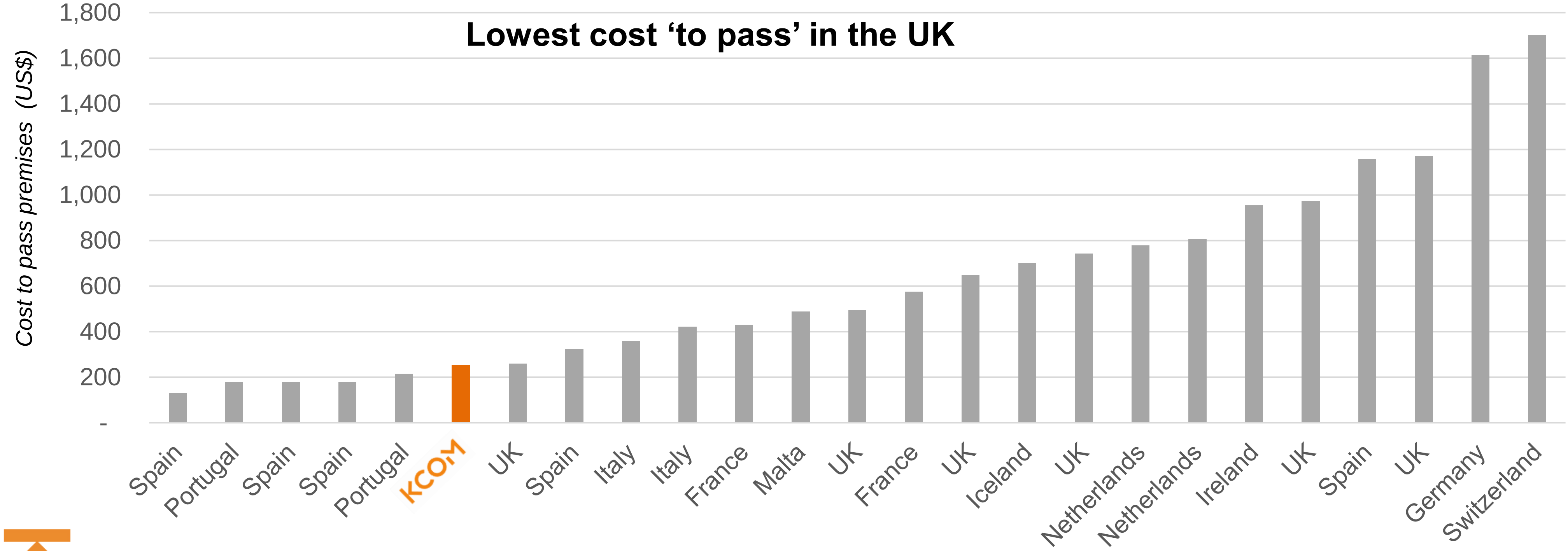
Hull and East Yorkshire

	FY17 £m	FY 16 £m	Change %
Revenue			
Consumer	56.1	54.7	3%
B2B	29.7	31.2	(5)%
Wholesale	11.0	11.6	(5)%
Core business revenue	**96.8**	**97.5**	**(1)%**
Media and Contact Centres	5.5	7.0	(21)%
Total revenue	**102.3**	**104.5**	**(2)%**
Gross margin	**78.5**	**79.2**	**(1)%**
Gross margin %	*77%*	*76%*	
Contribution	**60.4**	**59.8**	**1%**
Contribution %	*59%*	*57%*	

- Consumer revenue increased by 3% supported by continued fibre deployment with associated ARPU uplift to £34 per user per month
- Fibre deployment at lower cost and higher take up rate than originally anticipated
- Small decline in business revenue due to:
  - prior year impact of government superfast broadband scheme
  - reduction in public sector revenue
- Wholesale revenues stable
- Core revenue increases by 1% when excluding the one-off prior year impacts in business
- Anticipated decline in Contact Centres and Media
- Improved contribution margin

Fibre deployment progress

- Ahead of target to pass 150k premises by December 2017
- 45,000 premises passed during FY17, taking total to 137k
- Take-up remains strong at >30%. 19k premises connected in the year (including 1,400 businesses). Total connected now 43k
- Benchmarking is difficult, however, we believe both our cost to pass and cost to connect are the lowest in the UK based on available comparable benchmark information. In Europe, lower costs exist in areas of multiple dwellings



Source: Analysys Mason

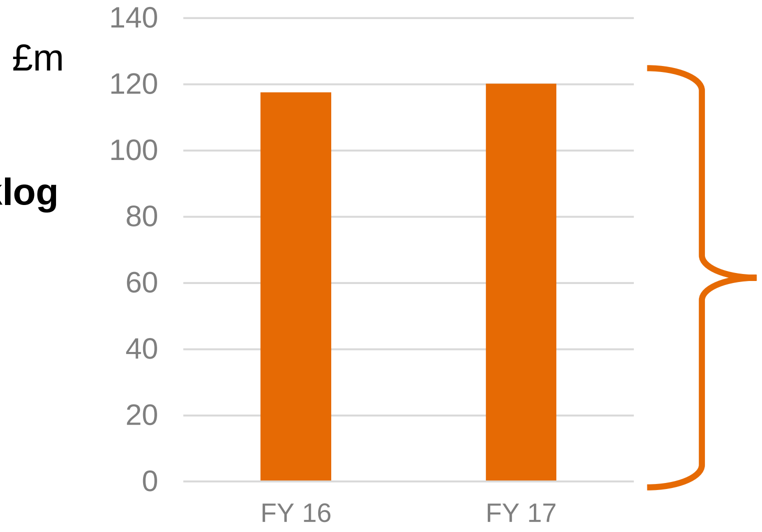
Enterprise

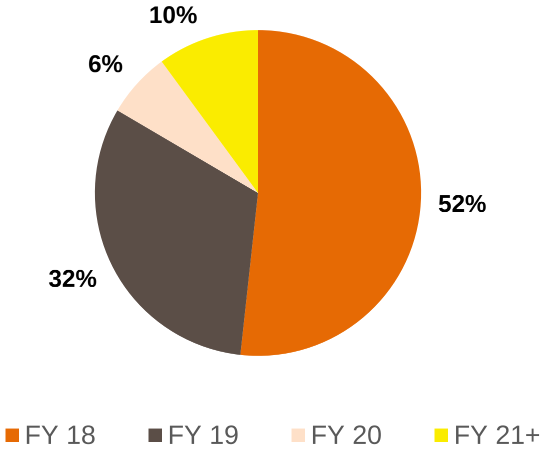
	FY17 £m	FY 16 £m	Change %
Revenue			
Projects	48.2	49.0	(2%)
Managed service	30.6	24.2	26%
Network	12.2	13.5	(10)%
Total revenue	**91.0**	**86.7**	**5%**
Gross margin	**25.6**	**28.6**	**(10)%**
Gross margin %	*28%*	*33%*	
Contribution	**4.5**	**8.2**	**(45)%**
Contribution %	*5%*	*9%*	

- Revenue growth of 5% driven by strengthening market reputation and growing key customer relationships
- Our enterprise business is focused on market areas where there is good growth and where we have market leading skills
- Revenue from our top 5 customers increased by 16% year-on-year
- Contribution affected by cost overruns on fixed price contracts with one customer leading to recognition of £3.6m loss for the build phase of these contracts
- Contribution margin is stable at 9% year-on-year after adjusting for this

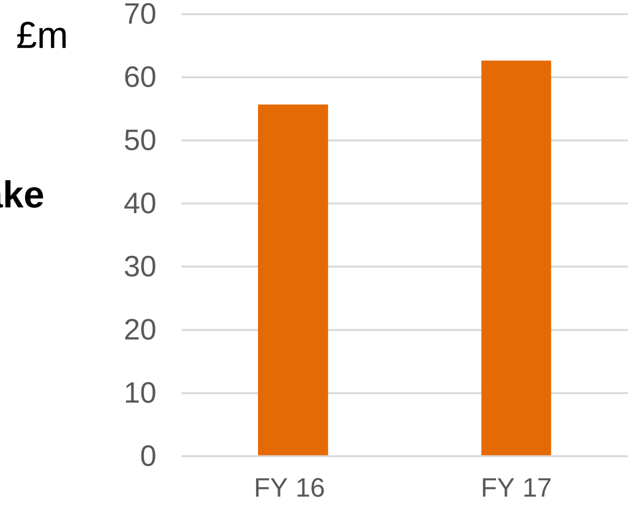
Strengthening sales position

Order backlog

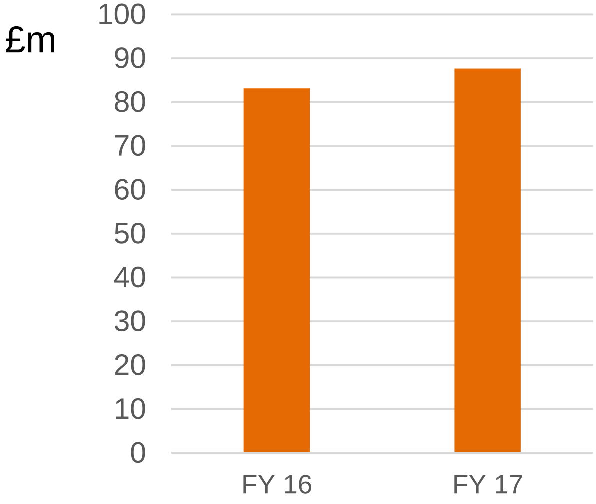




Order intake



First year revenue



Total contract value

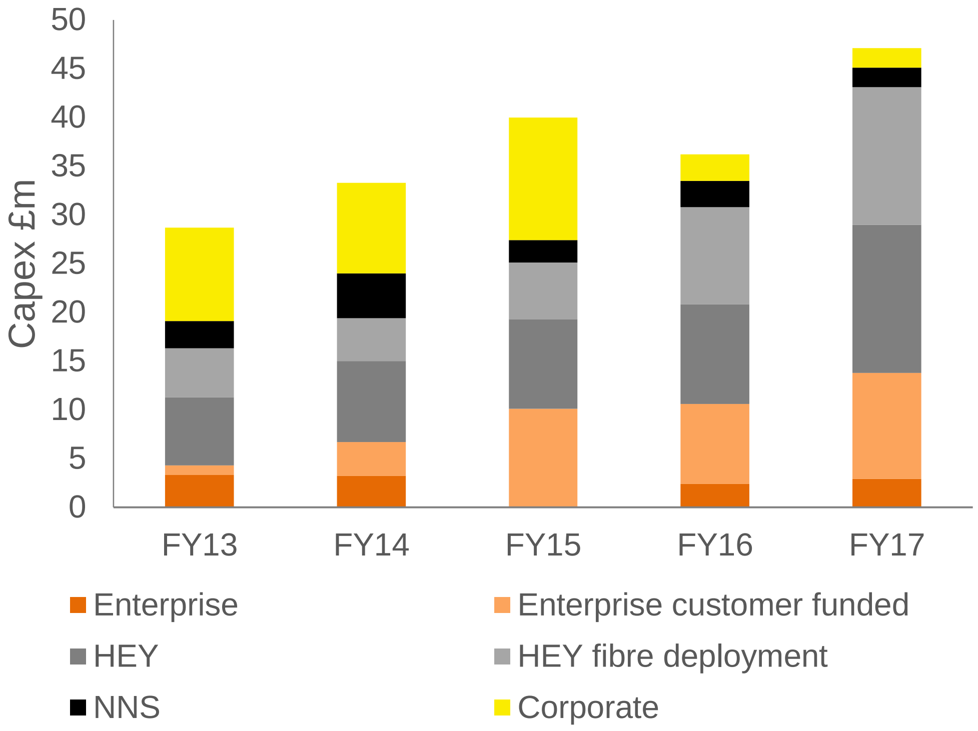
- FY18 has strong cover already in the backlog
- Order intake (excluding renewals) showed improvement year-on-year

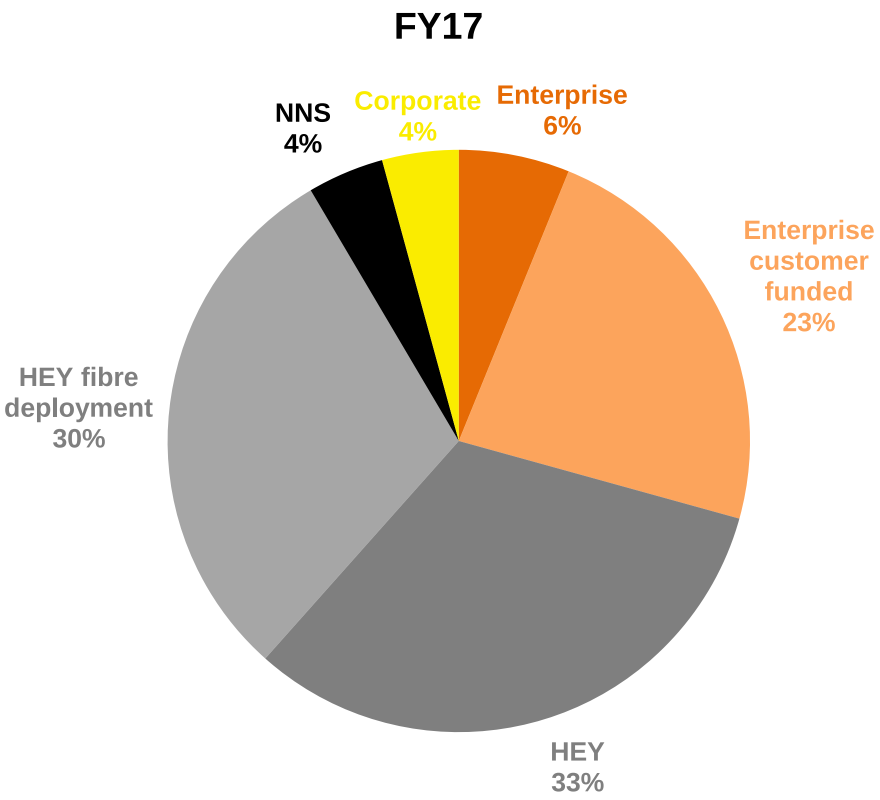
National Network Services

	FY17 £m	FY16 £m	Change %
Revenue			
Large Corporate	47.4	60.9	(22)%
SMB	52.6	55.2	(5)%
Partners	41.8	47.1	(11)%
Total revenue	**141.8**	**163.2**	**(13)%**
Gross profit	**41.0**	**44.9**	**(9)%**
Gross margin %	*29%*	*28%*	
Contribution	**16.0**	**19.3**	**(17)%**
Contribution %	*11%*	*12%*	

- We have a renewed focus on this segment to manage it for maximum value
- New management targeted with managing churn in the commodity end of the market along with driving value and growth in the less commodity areas
- Large Corporate revenue has declined as expected due to difficulty in differentiating ourselves in this commoditised part of the market. We expect this to continue to decline by another c £25m in FY18
- Focus is on providing value in the larger end of SMB market with resultant higher churn with some smaller customers
- Total revenue is expected to continue to decline in FY18 due to known losses in Large Corporate. After this, we expect it to stabilise

Capital investment

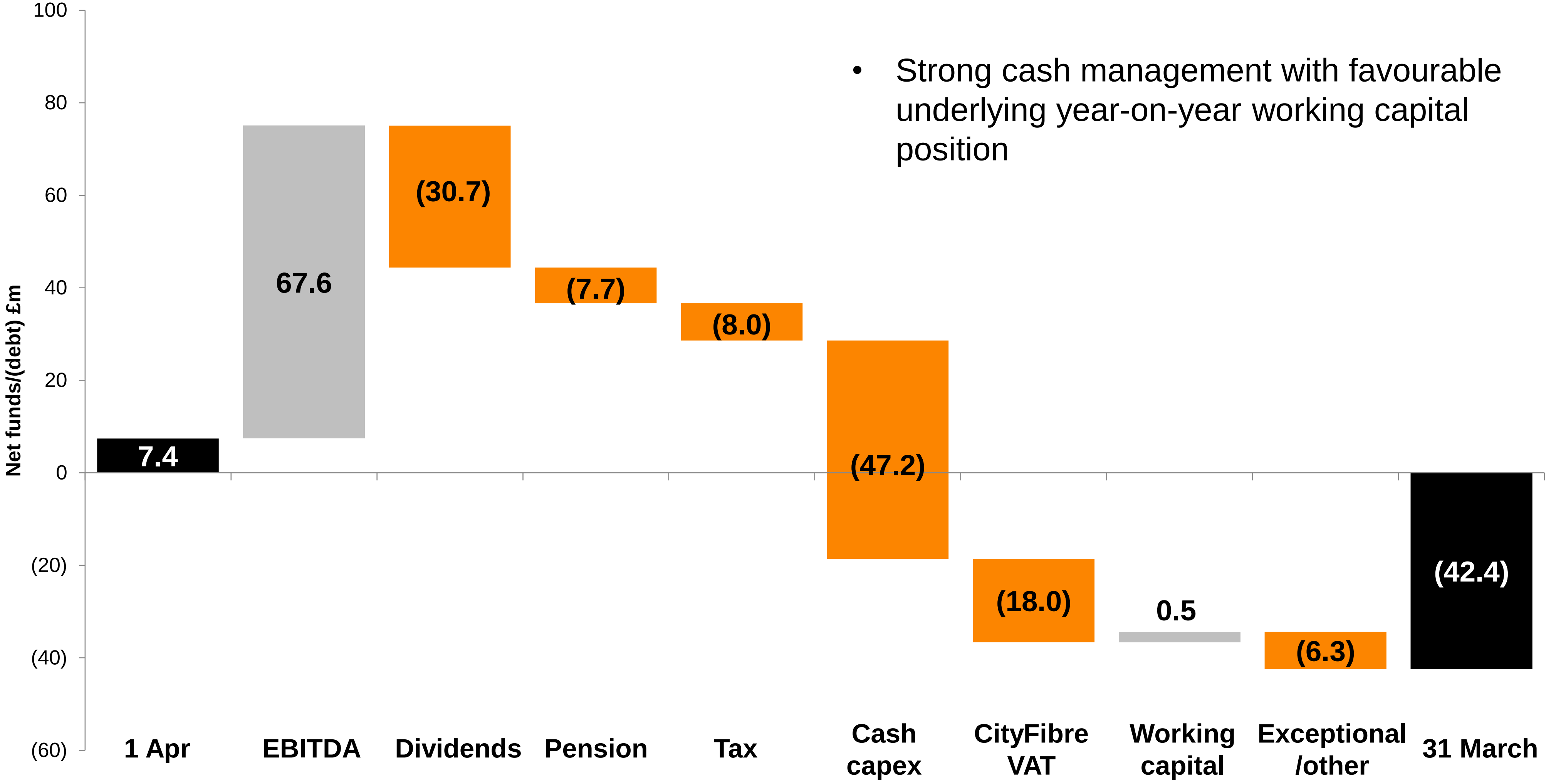




Segmentation of capex based on company's estimates

- Over last 5 years c 45% of our capital expenditure has been invested in our Hull and East Yorkshire segment, with c 63% invested in FY17
- Enterprise is relatively asset-light. Only c 6% of total capex in FY17 has been invested in Enterprise where it is not contract specific and funded by the customer as part of that contract
- Corporate spend in FY13-FY15 was on internal systems development

Net debt and cashflow



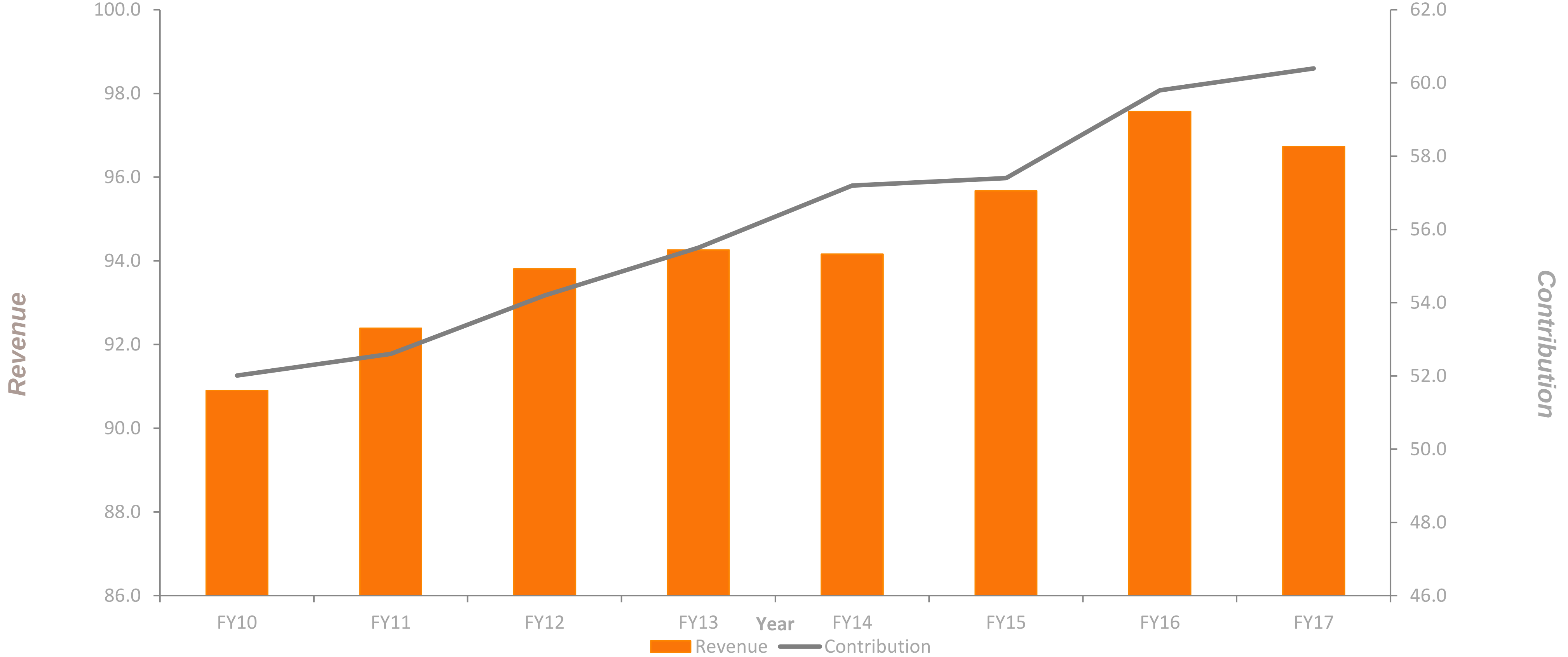
- Strong cash management with favourable underlying year-on-year working capital position

Business strategy:

Hull & East Yorkshire Enterprise

Bill Halbert

HEY– FY10-FY17 Revenue and contribution



FY11
Consumer Voice & Data bundles launched

FY12
Fibre deployment commences

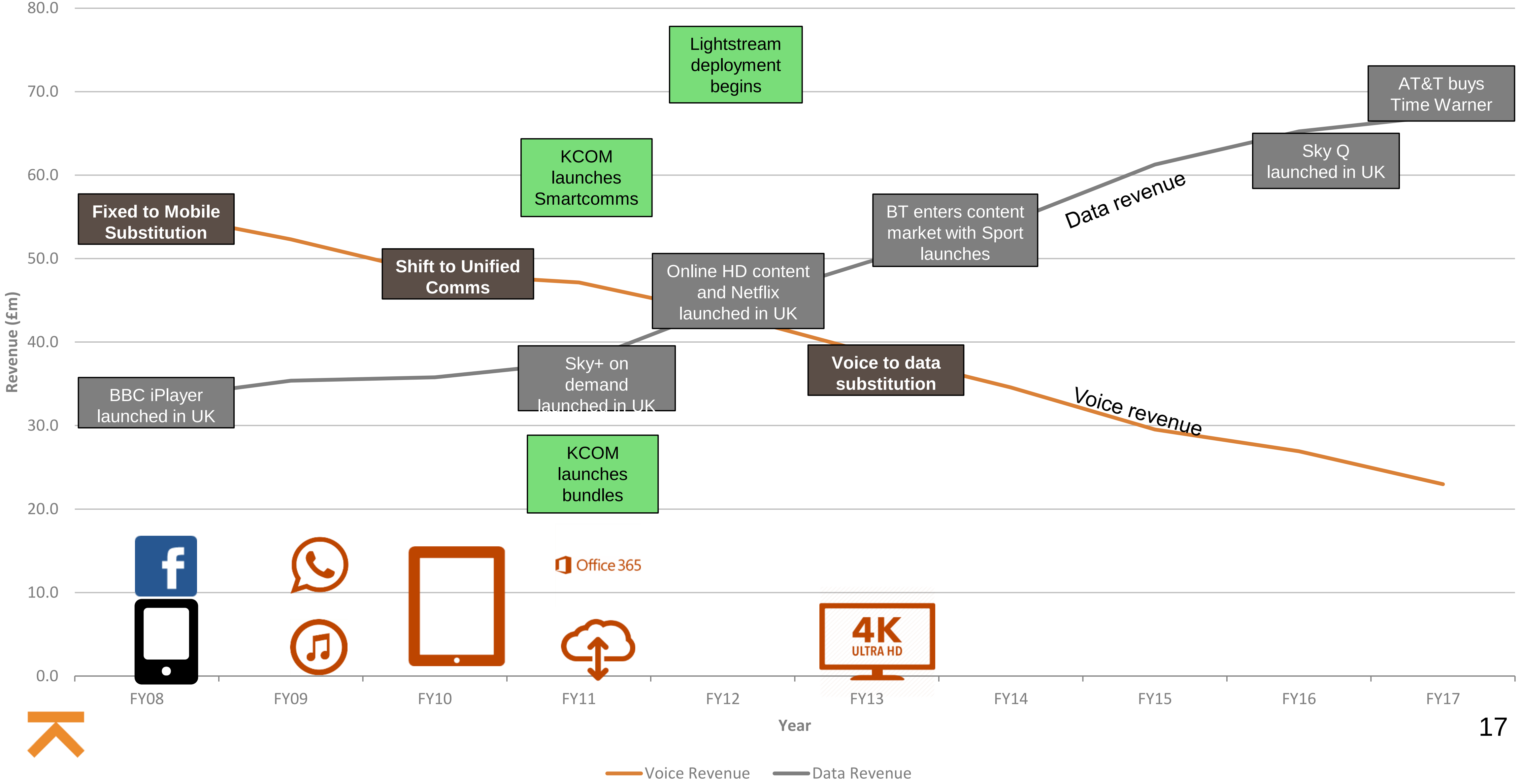
FY15
Business Voice & Data bundles launched

FY16
Business Super Connected Government Voucher Scheme

FY17
Decline in public sector spend due to YHPSN

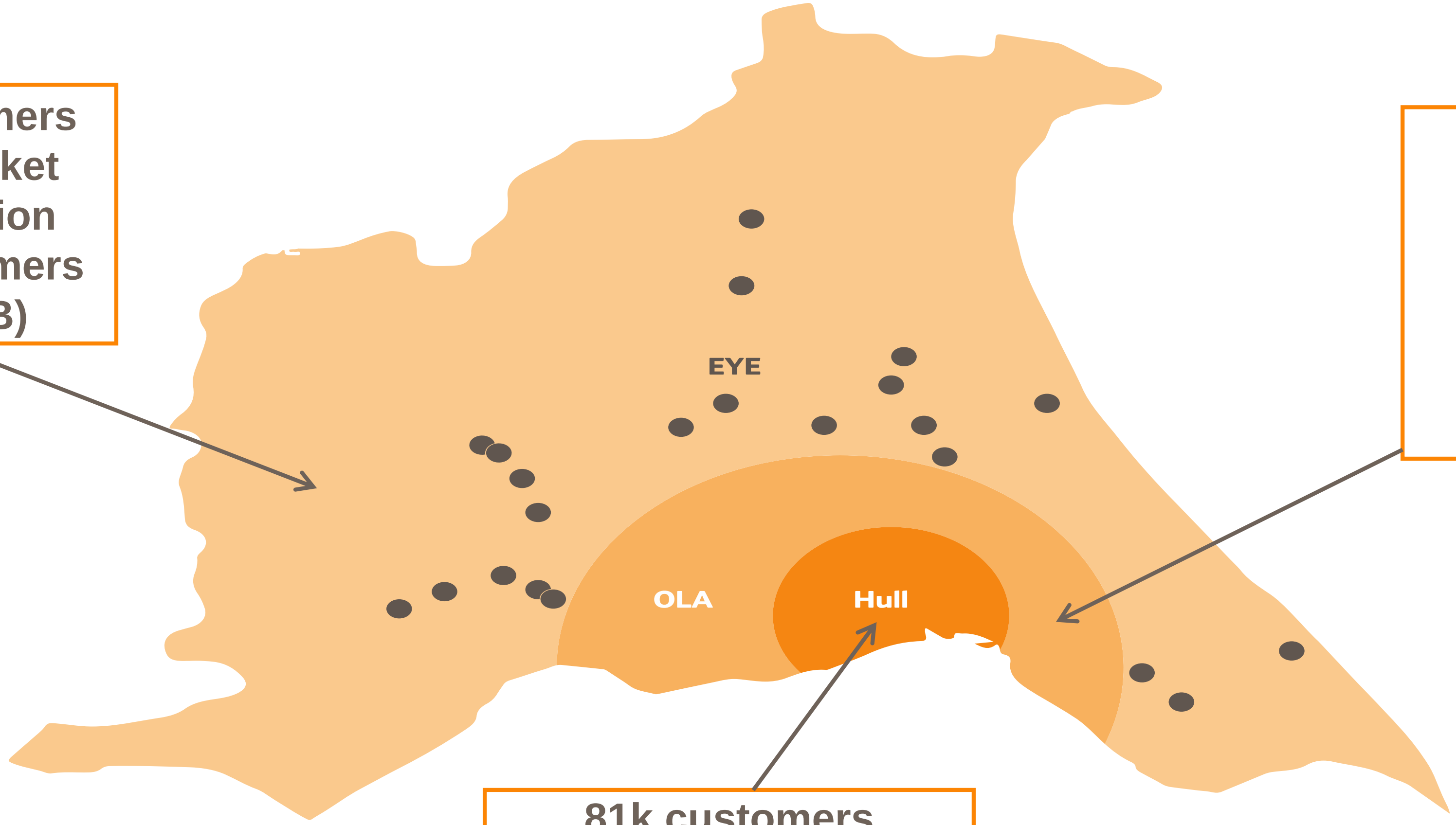
Revenue is Core business only (excludes Media and Contact Centres)
Contribution is total HEY. Central costs recharge based on management estimates from FY10-15.

Changing behaviours; technological evolution



Our consumer market

6k customers
27% market
penetration
(5k customers
22% BB)

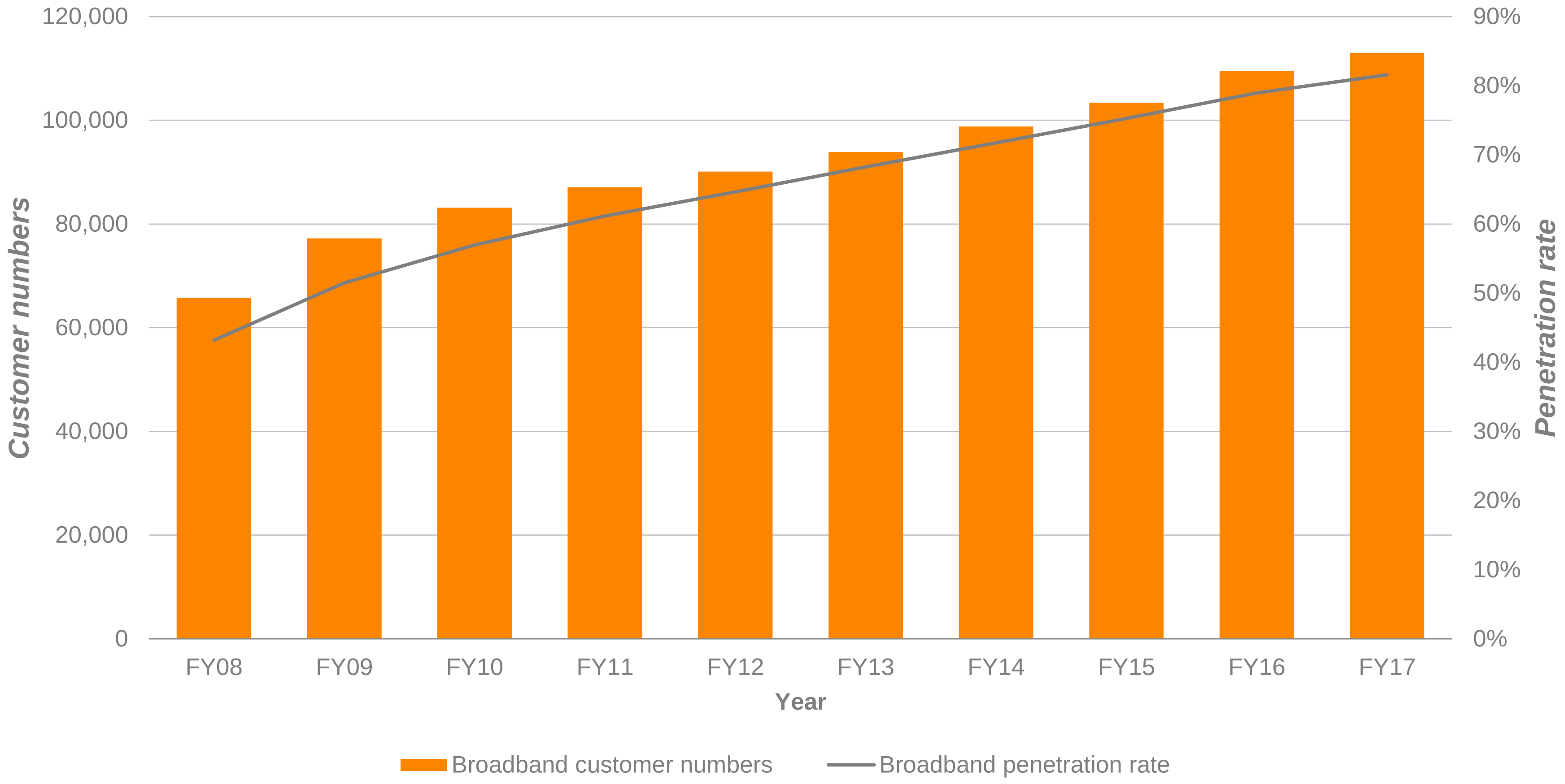


50k
customers
87% market
penetration
(44k
customers
75% BB)

81k customers
69% market
penetration
(71k customers
61% BB)

2016 UK Fixed BB Penetration = 79%

Consumer - FY08-FY17 Broadband Penetration



FY08-FY10
Traditional fixed line voice decline (outstripping rate of data growth)

FY11
Consumer Voice & Data bundles launched

FY12
Fibre roll out commences

The addressable broadband opportunity in HEY

16k non-users

66k Internet user households with competitors/alternative access

1.8k customers with competitors

Current Internet user types

All business types

Don't Use

16K

Outside home

5.5K

Mobile only

15K

14K

Fixed Basic

Fixed Typical

Fixed Savvy

20K (Fixed EYE only)

11.5K (Wireless)

1.2K

0.5K

0.1k

__16k__ non-users

__34.5k__ mobile-only (29k), or low-use adopters of 'free' Internet services (5.5k)

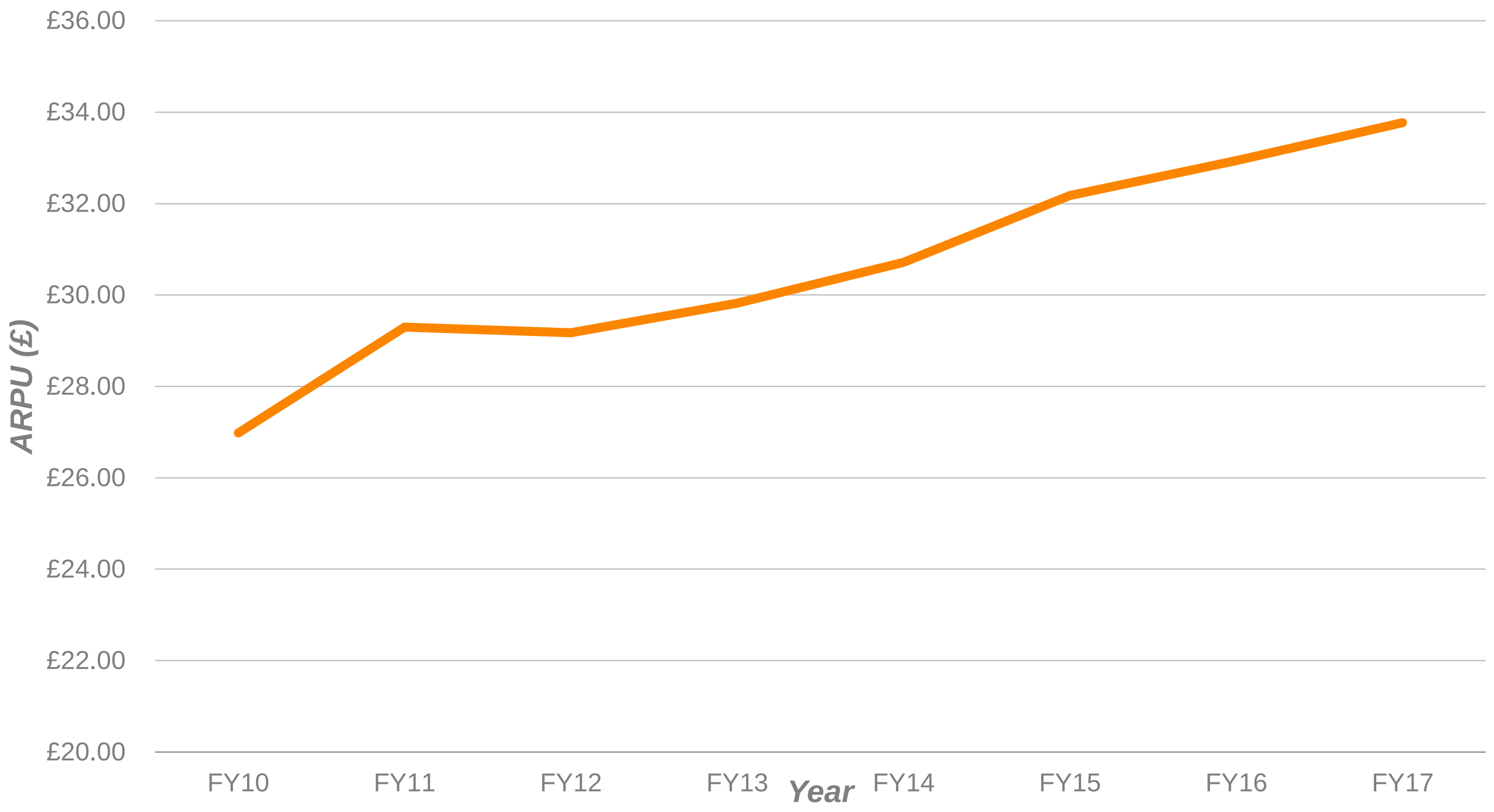
__31.5k__ Internet users with Wireless (11.5k) or fixed competitors (20k EYE only)

1200 customers with resellers

500 customers with Wireless

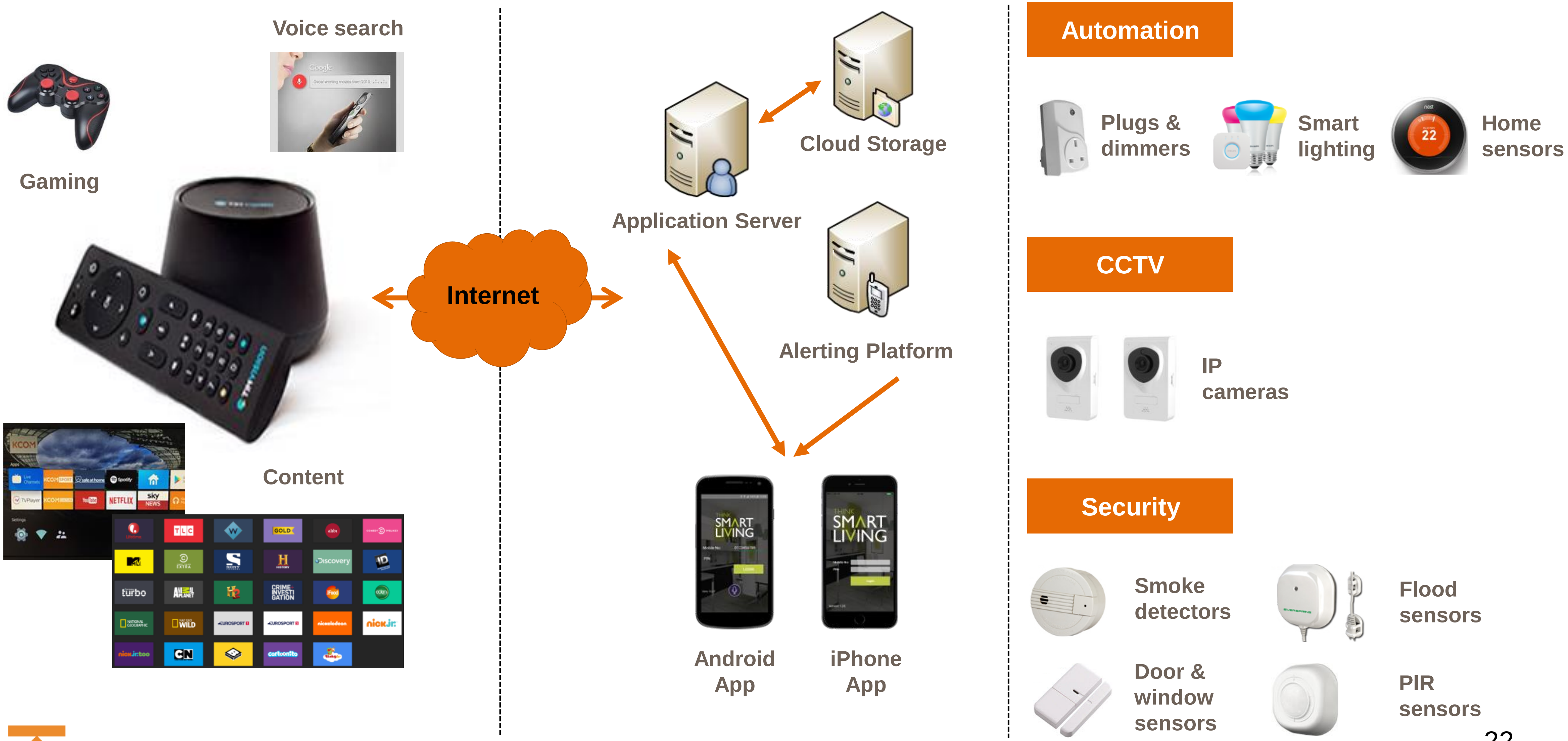
100 (est) with new network operators

HEY Consumer – FY10-17 ARPUs



Fibre & bundles adoption driving ARPU uplift

Future ARPU development: OTT services

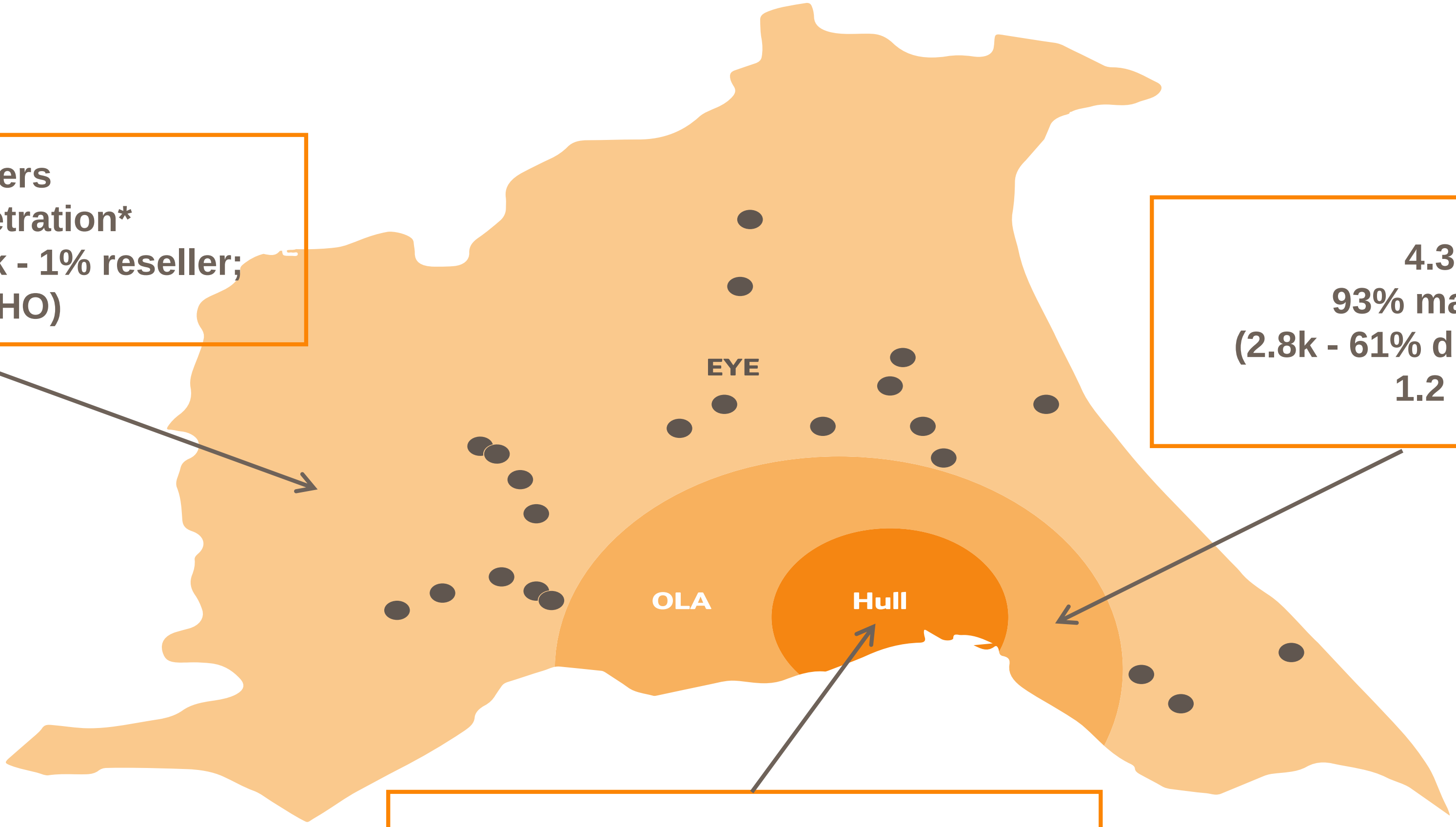


FY18 strategy - consumer

- Drive engagement, acquisition, upsell and retention through adoption model alongside cease analysis and deliver activities to minimise churn
  - Pass 35k properties with FTTP
  - Launch pick and mix bundles and KCOM TV application hub/platform
  - Develop and launch refreshed In-home Service Experience
- Deliver Customer Experience improvements
  - System and process investment, starting with Oneserve, followed by a billing initiative
  - Contact centre operational quality improvements
- Continue to manage and monitor ADSL network performance
  - Start conversion to fully fibre network

Our business market

0.4k customers
18% market penetration*
(0.3k - 12% direct; <0.1k - 1% reseller;
0.1k - 5% SOHO)



4.3k customers
93% market penetration
(2.8k - 61% direct; 0.3 - 7% reseller;
1.2 - 25% SOHO)

5.8k customers
89% market penetration
(4.3k - 66% direct; 0.7 - 10% reseller;
0.8 - 13% SOHO)

** penetration of on-net businesses*

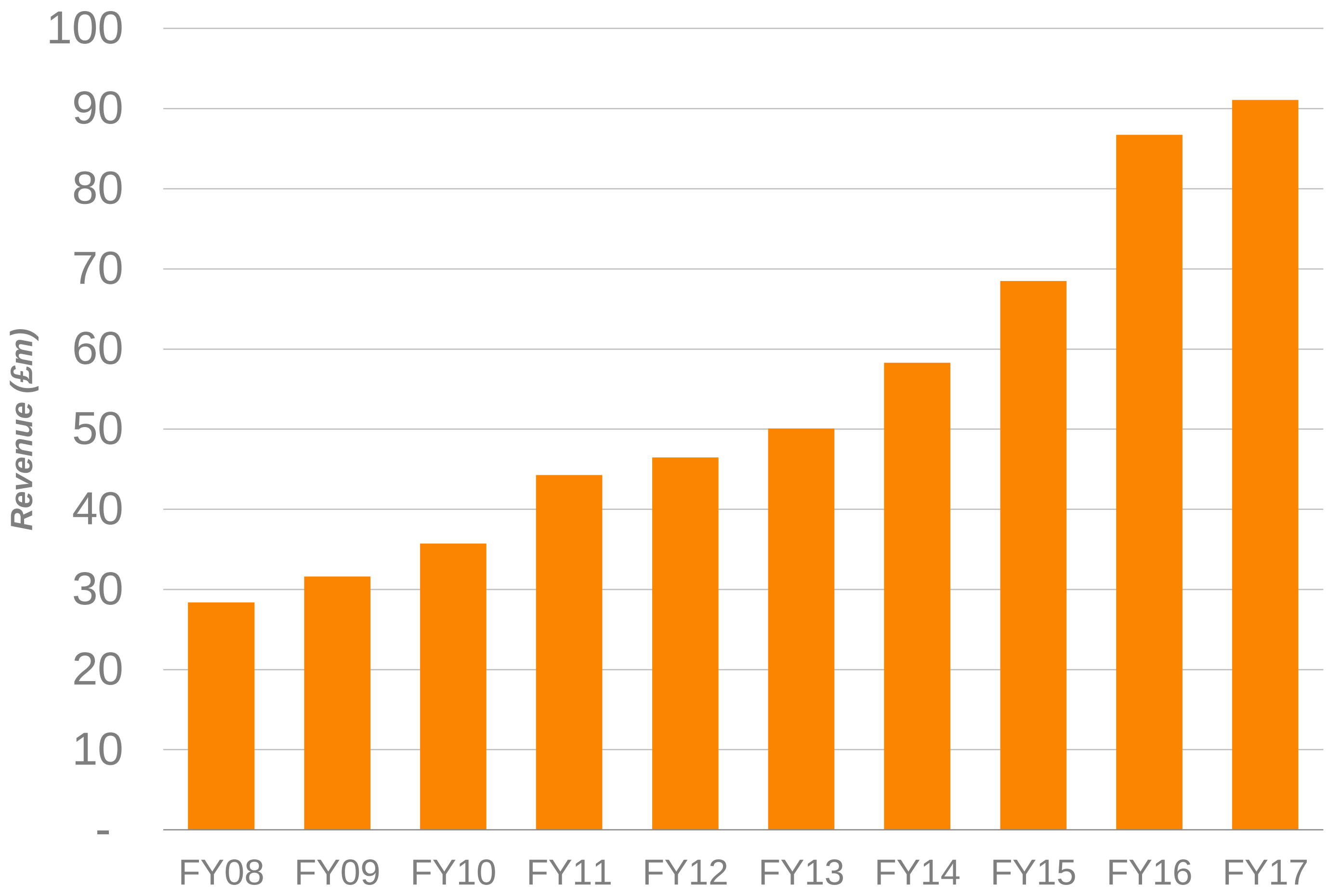
Business – FY18 Strategy

- Leverage the investment in fibre with the provision of increased focus on OTT services such as our SIP product, Smartcomms and security propositions

- Introduction of a new suite of propositions based on clear customer/prospect insight and segmentation to ensure the portfolio is relevant for all customers/prospects

- Differentiate through a clear strategy on improved customer experience with customers segments provided with a level of personalisation commensurate with their spend/opportunity.

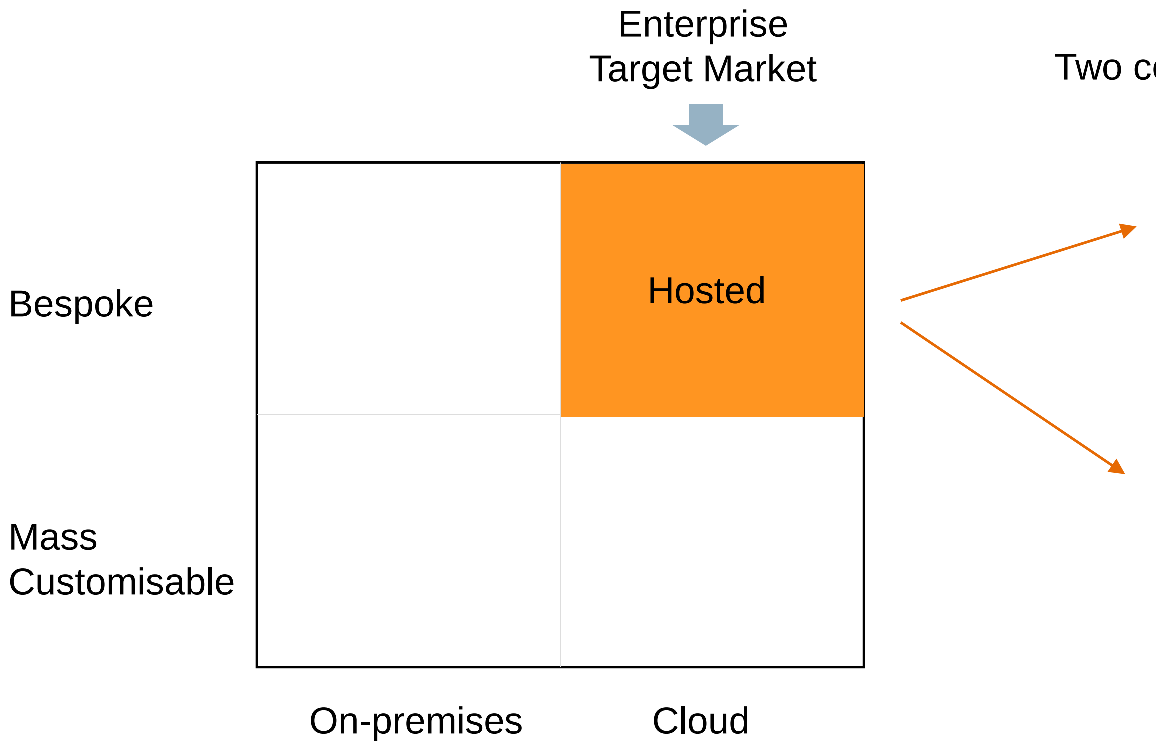
Enterprise: progress



Derived from management information from legacy brands

- Deepened existing customer relationship
- Deployed solutions across cloud and contact centre
- Investment in expanding sales team
- Creation of flexible, deployable talent pool
- Project management capability further developed

Enterprise growth is based on cloud delivered applications that require specialist services to create bespoke solutions



Two core elements of the current proposition

1. **Contact Centres (CCaaS)** eg HMRC, Bupa
   - Hosted
   - For larger Enterprises
   - Complex integrations

   Demand driven by customer experience improvements, cost savings and need for greater flexibility

2. **Cloud Professional Services (CPS)** eg RDG
   - Public cloud
   - Platform as a Service (PaaS)
   - Infrastructure as a Service (IaaS)

   Demand driven by lack of internal skills, massive transition to cloud and increasingly complex projects

Distinctive capabilities that provide competitive advantage

Contact Centre as a Service

- Demonstrated track record with transformation for largest contact centre in the UK, HMRC
- Preferred partner status with Cisco – certified Gold Partner
- KCOM Workplaces proposition capable of customisation through technology from multiple vendors

"We are now running, we believe, the largest virtual contact centre on the planet. Through the Contact Platform, we are able to support flexible working and new digital tools to help our customers interact with their digital accounts." **Mike Potter, Chief Digital & Information Officer**

HM Revenue & Customs

Contact Centre as a Service - HMRC

HM Revenue & Customs

Jan-14 — Appointed as technology partner for digital transformation

Transform contact centre environment:

- Hosted virtual contact centre
- IVR
- Call routing
- Call recording
- Speech recognition
- Adviser interface
- Analytics

Jan-15 — New contact centre environment in place for personal tax peak

Site-based roll-out to 21 locations and 6,800 personal tax employees by Dec 14

Largest hosted Cisco contact centre

Jan-15 — Additional functionality

Introduction and integration of:

- Webchat
- Co-browse
- Virtual assistant

Sept-15- Aug-16 — Phased expansion of Customer Service Platform into other departments

Supporting:

- debt management
- business tax
- back office functions
- Valuation Office Agency

Oct-16 — Improved support capability

24 hour, IT helpdesk

Jan-17 — Improve customer experience & personal data security

Launch of voice biometrics

Around 1 million registrations to date

Largest public-facing, public sector deployment in the world

Distinctive capabilities that provide competitive advantage

Cloud Professional Services

- Significant number of technical experts for cloud assignments, many of which are highly rated cloud architects
- Partnerships with 2 out of 3 key vendor partners and highest level of AWS accreditation
  - AWS – premier consulting partner
  - Microsoft – silver status; key Azure partner
  - Emerging relationship with Google
- Premier reference client who requires high-end consulting, architecting and development work

"Rail Settlement Plan, part of the Rail Delivery Group has awarded KCOM three significant contracts, each for a business critical application forming part of a suite of applications that support the retailing of train tickets. This was on the strength of their competitive proposal and on demonstration of their capability to deliver in a way which matches the requirements of our organisation," **Steve Howes, Managing Director**

Rail Delivery Group

National Rail

BRITAIN RUNS ON RAIL

Cloud capabilities - RDG

Rail Delivery Group

National Rail | BRITAIN RUNS ON RAIL

Workload Migration

National Rail Enquiries (**NRE**)

2013

Managed service for all applications and a single service desk

Provide rail customers with a faster, smoother and more reliable ticketing experience

Architect for the Cloud

Live Sales Management (**LSM**)

2014

Supporting RDG's 'Click and Collect' Ticket on Departure service

Handles over a billion tickets per year from 2500 ticket machines

South East Flexible Ticketing (**SEFT**)

2015

Easy to use smartcard ticketing experience

Handles ticket fulfilment, interface with web retailers and provide a modern and responsive web user interface

Cloud Native

Data Capture, Apportionment & Settlement (**DCAS**)

2018

System to distribute over £9 billion of annual ticket revenues with apportionment based on 2 million business rules

Collects sales data from 8,500 ticket-issuing systems from retailers

Replacement Availability & Reservation System (**RARS**)

2018

System to handle over 1 billion enquiries per month, holds details of journeys, fares, trains, carriages, seats etc. and allows passengers to book seats and for those seat reservations to be managed across all train operating companies

Next steps - Enterprise

These capabilities allow Enterprise to expand the range of markets served…..

Initial focus

- CCaaS
- CPS PaaS, IaaS

Medium focus

- Security
- Identity

Longer term focus

- IOT
- Big Data
- Machine Learning

Summary

- Board is confident in the potential from KCOM transition into
  - a regional fibre based services provider through continued deployment of fibre and development of over-the-top services
  - a provider of complex IP solutions to the enterprise market, driven in the near term by expanding presence in IP-services focused on contact centre and cloud services.
- Remain focused on creating a simplified business which will operate on a reduced cost base and that continues to generate sustainable returns and growth for shareholders.