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