KCOM group

Preliminary results for the year ended 31 March 2015

Highlights

- Second phase of our transformational journey
- Performance in line with expectations; progress across all key focus areas
- Pre-exceptional operating profit up 4 per cent to £57.2m (2014: £55.0m)
- Adjusted basic EPS up 5 per cent to 7.91p (2014: 7.55p)
- Success of and growth in demand for IP based “Workplaces” portfolio, including successful HMRC implementation and further significant opportunities in pipeline
- Continuing growth in demand for fibre-based services
  - Decision to accelerate deployment
- Proposed full year dividend of 5.37p (2014: 4.88p), representing sixth year of commitment to 10 per cent dividend growth

Financial performance

Paul Simpson

Chief Financial Officer

Summary financial results

	Mar 15 £m	Mar 14 £m	Movement
Revenue	348.0	370.7	⇩
EBITDA	74.3	75.3	⇩
EBITDA %	*21%*	*20%*	⇧
Operating profit	57.2	55.0	⇧
Adjusted basic EPS (pence)[1]	7.91	7.55	⇧
Net cash inflow from operations	50.6	71.3	⇩
Net debt	99.3	75.0	⇧
Proposed full year dividend per share (pence)	5.37	4.88	⇧

[1]Adjusted basic EPS is basic EPS adjusted for exceptional items (including the tax impact of the exceptional items).

All amounts are before exceptional items.

Kcom brand

Improved mix and cost base part-compensating for lower revenue

	Mar 15 £m	Mar 14 £m	Movement £m
Revenue	**188.8**	**214.3**	**(12%)**
Operating margin	**52.8**	**60.2**	**(12%)**
Operating margin %	*28%*	*28%*	
SG&A	**37.3**	**41.9**	**(11%)**
SG&A to revenue %	*20%*	*20%*	
EBITDA	**15.5**	**18.3**	**(15%)**
EBITDA %	*8%*	*9%*	
LTM EBIT	10.9	10.3	6%
Capital employed[1]	81.8	104.6	(22%)
ROCE [2] (post impairment) [3]	**13%**	**10%**	
ROCE (pre impairment)	**9%**	**10%**	

[1] Capital employed calculation detailed in the Appendix.
[2] All ROCE % are pre-tax.
[3] Mar 15 includes an impairment charge of £33.9m.

- Revenue reduction in the year has an adverse impact on the quantum of the operating margin reported albeit operating margin % is consistent
- New customer growth (incl. HMRC) insufficient in the current year to offset some specific areas of ongoing reduction (network-based bandwidth, wholesale network services – £15m) and lower product revenue in FY15 - £3m
- Actions initiated at the half year to reduce the overall cost base partially offset the operating margin reduction such that overall EBITDA margin materially consistent year on year
- Post impairment (pre-tax) ROCE improves to 13% reflecting the £33.9m reduction in capital employed compared to 9% (FY14: 10%) pre-impairment

Smart421 brand

Return to growth in the second half of the year

	Mar 15 £m	Mar 14 £m	Movement
Revenue			
Major account	2.4	7.6	(68%)
Other business	27.8	22.4	24%
	30.2	**30.0**	**(1%)**
EBITDA	**3.1**	**3.7**	**(16%)**
EBITDA margin %	*10%*	*12%*	
LTM EBIT	3.0	3.6	(17%)
Capital employed[1]	10.8	9.7	11%
ROCE	**28%**	**37%**	

[1] Capital employed calculation detailed in the Appendix.

- Another year of strong returns with a return to overall growth in the second half of the year
- Allowing for the reduction within one specific major account, Smart421 grew at 24%
- Whilst overall returns and EBITDA were impacted by the reduction in business with a major account, overall returns and profitability still attractive with potential for further improvement given second half growth
- Opportunity remains for penetration of other Group relationships (primarily Kcom) alongside complementary proposition development around cloud and integration solutions

Eclipse brand

Business revenue and total EBITDA growth

	Mar 15 £m	Mar 14 £m	Movement
Revenue			
Business	25.4	21.2	20%
Consumer	4.2	5.4	(22%)
	29.6	**26.6**	**11%**
EBITDA	**7.1**	**6.7**	**6%**
EBITDA %	*24%*	*25%*	
LTM EBIT	5.6	5.6	-
Capital employed[1]	14.5	12.1	20%
ROCE	**39%**	**46%**	

[1] Capital employed calculation detailed in the Appendix.

- Another strong year of performance with 11% and 6% overall growth in revenue and EBITDA respectively
- Business growth of 20% reflects new customer acquisition and product penetration into existing customer base
- Investment in growth behind cloud-based services provides for continuation of growth and margin expansion
- Overall returns remain attractive and consistent with prior year

KC brand

Consumer growth and improving business trend

	Mar 15 £m	Mar 14 £m	Movement
Revenue[1]			
Consumer	53.4	50.7	5%
Business	30.3	30.6	(1%)
Wholesale	12.0	12.8	(7%)
	95.7	**94.1**	**2%**
EBITDA[1]	**55.6**	**54.0**	**3%**
EBITDA %	*58%*	*57%*	
LTM EBIT	47.8	46.8	2%
Capital employed[2]	59.9	47.7	26%
ROCE	**80%**	**98%**	

[1] Revenue and EBITDA above exclude Contact Centres and Publishing.
[2] Capital employed calculation detailed in the Appendix.

- KC performance continues recent trends with headline revenue growth and improving EBITDA (£ and margin)
- Revenue performance strongest in consumer segment at 5% growth aided by fibre deployment and further broadband penetration
- Reduction in the rate of business revenue decline to 1% (3% in prior year) as fibre customers increase
- Wholesale revenue reduction largely reflective of Voice regulatory impact
- Overall returns continue to be very strong with increase in capital employed a result of investment in next generation fibre services

Movement in net debt

	Mar 15 £m	Mar 14 £m
EBITDA reported	39.5	75.9
Working capital movement	(14.9)	1.5
Exceptional items – non cash (impairment)	33.9	-
Exceptional items - cash	(0.1)	(3.4)
Pensions	(4.3)	(0.8)
Other operating cash items[1]	(3.5)	(1.9)
Net cash inflow from operations	**50.6**	**71.3**
Capex – cash	(32.0)	(27.9)
Interest	(5.6)	(4.4)
Dividends	(26.1)	(23.8)
Share purchases & dividend equivalents	(4.7)	(2.1)
Other	0.3	0.1
(Increase)/Decrease in net bank debt[2]	**(17.5)**	**13.2**
Net increase in finance lease liabilities	(6.9)	-
(Increase)/Decrease in net debt	**(24.4)**	**13.2**
Net debt: EBITDA ratio[3]	**1.3 x**	**1.0 x**

[1] Includes tax payments of £3.4m (Mar 14: £1.5m) and net profit on sale of PPE and investments of £0.1m (Mar 14: £0.4m).
[2] Net bank debt is net debt excluding finance leases.
[3] EBITDA is before exceptional items.

Continuing our transformation journey

Bill Halbert

Chief Executive Officer

Continuing the journey

- Business transformation continues to create more agile operating model:
  - Integration of brands to focus investment on growth in the Enterprise, Small and medium-sized business (SMB) and Consumer
  - Continued move towards effective, efficient support services/back office operations; implementation of common systems and processes support consolidation of teams

- Continued execution of strategic growth opportunities
  - Growing interest in cloud and collaboration capabilities
  - Strong demand for fibre and broadband services, well ahead of national average

Market focus

Enterprise & Public Sector

We help customers meet their business needs, growth and cost outcomes through the integration of collaboration and communications tools

SMB

Deliver connectivity, cloud and communications through one subscription- based relationship, with an exceptional service experience

Consumer

Provide broadband-based services to help people communicate and live their lives in a digital age

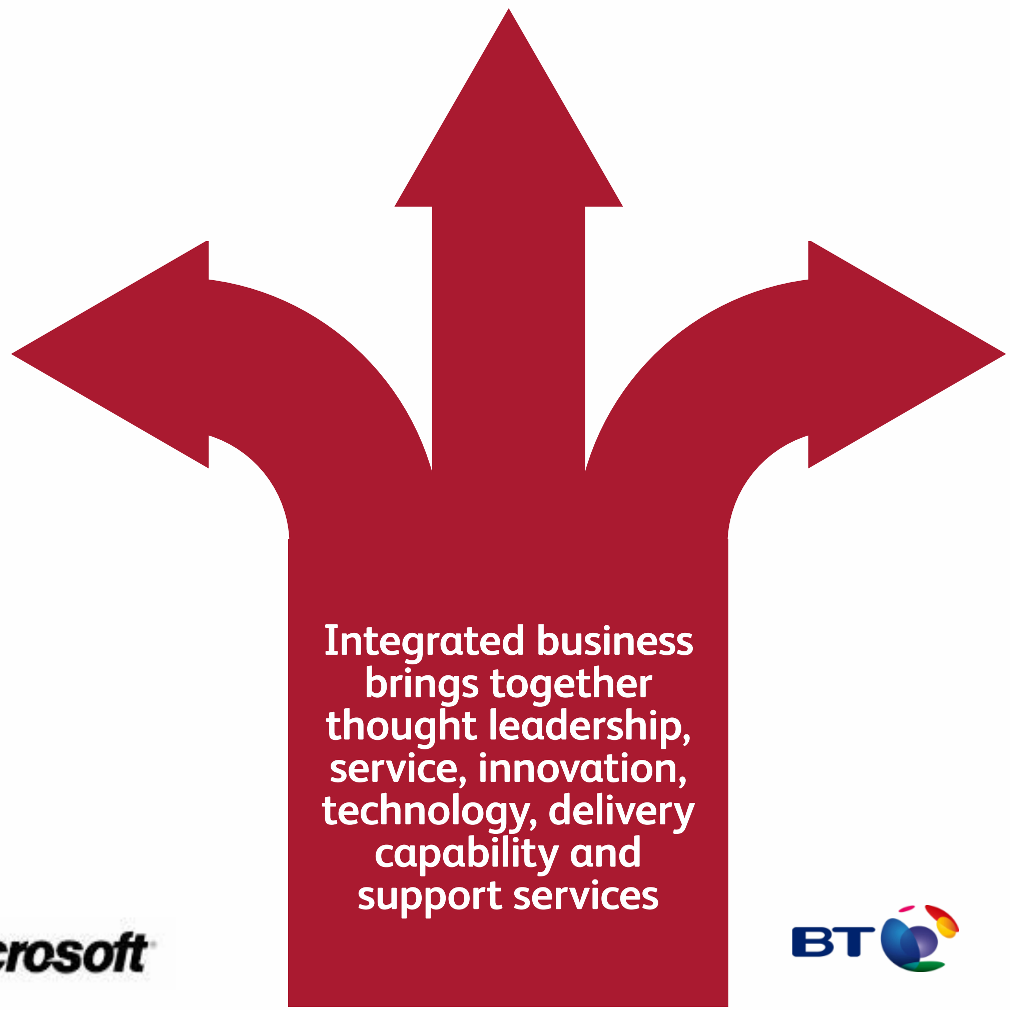
Group provides thought leadership, capability, service, innovation and technology

Creating a more agile approach

SMB

Enterprise

Consumer



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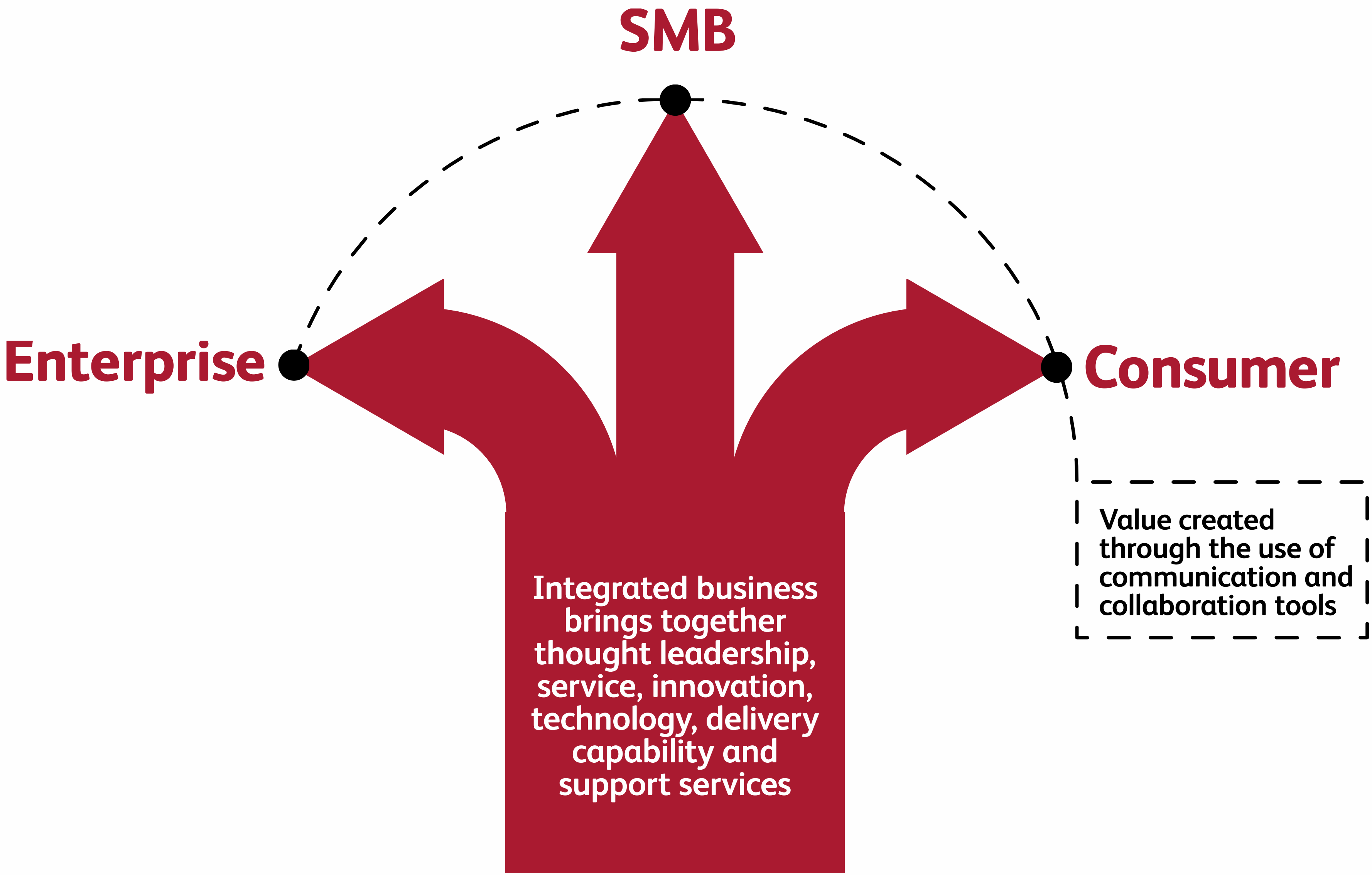
Creating a more agile approach



Enterprise

Bespoke design and delivery

Being connected

Our clients recognise the value of being better connected – to their employees, partners and customers. To achieve this they need to join up their technology architecture.

Being agile and responsive

Our clients need to be able to adapt – to flex their technology architecture to respond to changes in demand, with ability to respond quickly to new customer or business needs.

Being secure

Our clients need to ensure their data, systems and core assets are secure, in an ever connected world where the organisational boundaries are increasingly blurred.

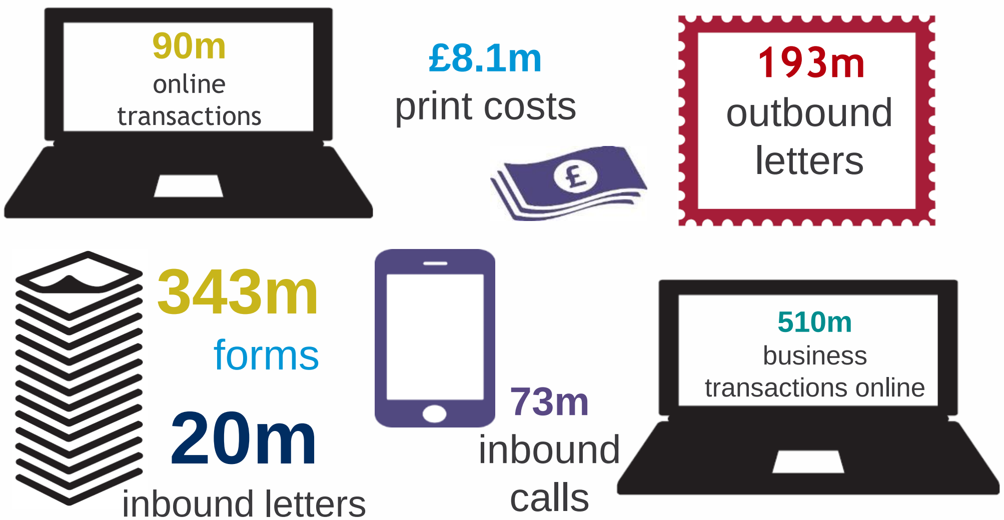
Our propositions

The following propositions are aligned with CIO agenda and are designed to meet market demand.

1. Consulting
2. Connected Enterprise
3. Contact and Collaboration
4. Cloud Adoption
5. Smart Identity
6. Data and Voice Analytics

Case study

Helping HMRC transform



Solution live in preparation for 31 January peak:

- An average of 228,000 inbound calls per day
- Nearly 6 million calls in total

> "We're in the middle of rolling out a completely virtual call centre solution across the whole of HMRC. That's being delivered by an SME - Kcom - who I have to say have been absolutely fantastic, and totally got the cultural stuff around how to work with us and how to be agile".
>
> ***Mark Dearnley, HMRC CDIO***

SMB

Flexible, packaged proposition

By leveraging the capability across our portfolio of connectivity, communications, cloud and consulting services, we can take our customers on a transformational journey. We're experts in combining our own capability with that of our partners to create a seamless experience.

Connect better

Our customers need to be connected to their colleagues, partners and customers, whether in the office, out in the field or at home.

Communicate better

Our customers need to communicate in ways that create new experiences, allowing them to be more productive and successful.

Collaborate better

Our customers need their data and business applications to be available wherever, whenever and by whomever they choose.

Care better

Using technology to support independent living and self-care.

Our propositions

…are aligned to our customer needs and to growth markets:

They include:

1. Always connected
2. Joined-up communications
3. Your data where you need it
4. Work anywhere, anytime
5. End user compute and services
6. Safe at home

Case study

Helping Furniture Village to grow

- Retailer wanted to exploit all the new technologies such as unified communications and cloud-based services to enable collaboration across sites and maximise the potential of their business
  - High speed WAN connections to stores
  - Increased reliability
  - Efficiency saving
- Improved network resilience using Bonded DSL lines
- Online access to network monitoring and diagnostic tools

"As an out-of-town retailer in the UK, there is a constant challenge of providing cost-effective and robust data connectivity to sites that do not benefit from fibre connectivity. As the convergence of data, voice and video grows, so too does the requirement for greater bandwidth.

"Eclipse's bonded broadband solution has provided Furniture Village with a scalable and resilient alternative to leased lines, upon which new commercially targeted IT services can now be built. "

Ian McBeth, Group IT Controller, Furniture Village

Consumers

Mass customisation of services

UK households have an average of three different types of internet-connected device*

Lightstream-connected household downloads more than twice as much data each month than the average household with a standard copper broadband connection

Data-hungry services and applications including free on-demand TV and subscription-based content services such as Netflix and Amazon Prime Instant Video continues to grow

Accelerated deployment of fibre based services

- 41,000 homes passed as at 31 March 2015
- 33 per cent take-up remains well above UK average
- Over the top content driving demand
    - You View from KC
    - KC Sport
    - KC Culture
    - Cold alarms

Market opportunity for growth in fixed-line consumer broadband services is by developing new propositions to appeal to the needs of a wider range of customers

*2013 Ofcom UK Communications Market survey

Outlook

- Continue execution of transformation strategy
  - Deliver greater value to customers
  - Align assets and resources to serve three market segments
- Create agile operating model
  - Integrate existing brands
  - Investment prioritised in strategic growth areas
  - Ongoing consolidation of business-wide operational support
- Expect further progress across growth opportunities

Appendices

Summary financial results

By Brand and Segment

	Revenue £m	EBITDA £m
KC	95.7	55.6
Contact Centres & Publishing	9.1	0.8
Total KC segment	**104.8**	**56.4**
Kcom	188.8	15.5
Eclipse	29.6	7.1
Smart421	30.2	3.1
Total Kcom segment	**248.6**	**25.7**
PLC segment	(5.4)	(7.8)
KCOM Group	***348.0***	***74.3***

Balance sheet extract

	Mar 15 £m	Mar 14 £m
Non-current assets[1]	169.0	146.5
Trade and other receivables	78.8	74.1
Trade and other payables	(113.0)	(128.3)
IAS 19 retirement benefit obligation	(31.4)	(26.5)
Net debt	**99.3**	**75.0**
Net debt: EBITDA ratio	**1.3 x**	**1.0 x**
Net bank debt[2]	92.4	75.0
Net bank debt: EBITDA ratio[3]	1.2 x	1.0 x

[1] Non-current assets includes property, plant and equipment and other intangibles assets only.
[2] Net bank debt is net debt excluding finance leases.
[3] EBITDA is before exceptional items.

Capital Employed calculation

Mar 15	KC £m	Kcom £m	Eclipse £m	Smart421 £m	PLC £m
Fixed assets	71.6	64.1	2.3	0.2	30.8
Goodwill	-	38.4	7.9	5.1	-
Trading capital[1]	(11.7)	(20.7)	4.3	5.5	(1.4)
Capital employed[2]	**59.9**	**81.8**	**14.5**	**10.8**	**29.4**

Mar 14	KC £m	Kcom £m	Eclipse £m	Smart421 £m	PLC £m
Fixed assets	66.8	57.5	1.6	0.1	20.5
Goodwill	-	72.3	7.9	5.1	-
Trading capital[1]	(19.1)	(25.2)	2.6	4.5	(6.5)
Capital employed[2]	**47.7**	**104.6**	**12.1**	**9.7**	**14.0**

[1] Trading capital represents current assets and current liabilities excluding any intercompany balances.
[2] Capital employed is calculated using year end balances.

Pensions

Discount rate driving increased deficit

	Mar 15 £m / %	Mar 14 £m / %
Retirement benefit obligation (IAS 19)	(31.4)	(26.5)
Assumptions		
Discount rate	3.25%	4.3%
RPI	2.95%	3.4%
Sensitivity analysis[1]		
Discount rate	4.6	
RPI	(2.2)	

[1] Shows the impact on the Mar 15 retirement benefit obligation of a decrease in each assumption by 1%.