KCOM

Interim results

for the six months ended 30 September 2017

28 November 2017

Business strategy & progress

Bill Halbert

Key points

Hull & East Yorkshire

- Strong performance with revenue growth in each of its core sales channels
- Fibre to be available to 75% of market by December
    - Final 25% deployment investment confirmed and due for completion March 2019

Enterprise

- Revenue growth affected by UK General Election and impact of proposed exit of one of the complex software contracts
- A number of new contracts and the renewal and extension of its relationship with NFUM
- Contribution reduced by £6.2m due to further losses incurred and anticipated on our complex software contracts
- Excluding the impact of these contracts, revenue, gross margin percentage and contribution percentage would all have grown

National Network Services

- Legacy revenue decline as expected

Overall

Group revenue declined; EBITDA margin percentage maintained

Remain confident in medium term prospects; with interim dividend of 2.00p confirmed, consistent with stated commitment

KCOM - Creating shareholder value

Income and capital growth

Enterprise	Hull & East Yorkshire	National Network Services
IP-based communications and collaboration services for UK enterprises	Communications based services for the region's consumers and businesses	Connectivity-based services for organisations nationwide
Investment light/ customer funded	**Investment focus**	**Limited investment**
Growth	**Income**	**Manage for value**
	140,000+ homes 7000+ small & medium businesses	

Hull & East Yorkshire

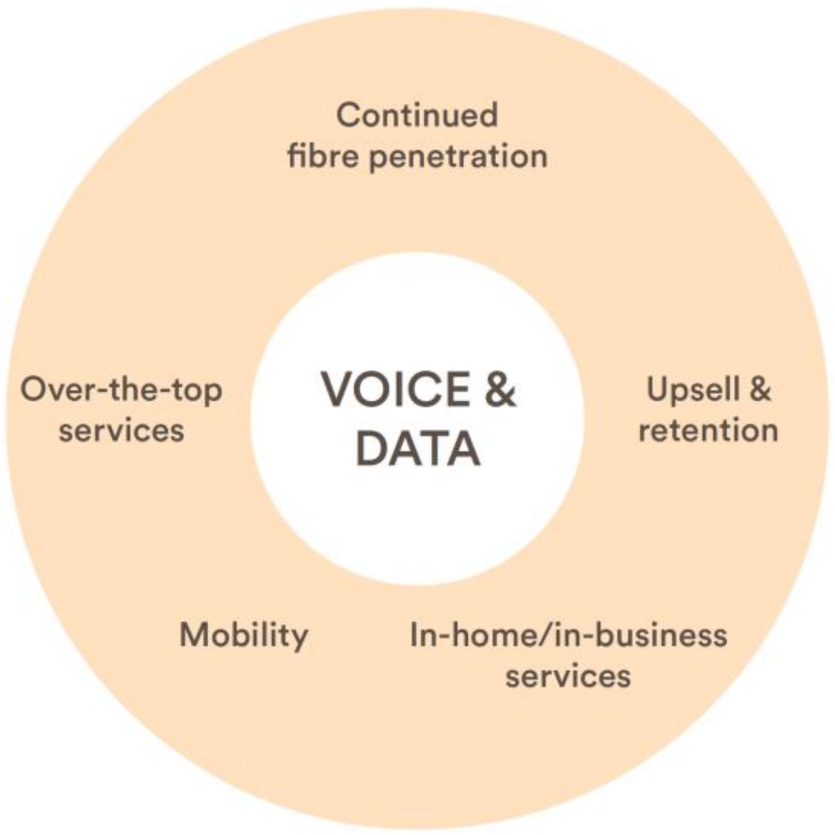
Growth focus

Adoption and trends

- Continue to drive customer acquisition, upsell and retention
- Further development of mobile proposition
- Increased focus on development of over-the-top services
- Improved, more personalised customer experience

Infrastructure and technology

- Fibre availability to full addressable market by March 2019
- Network transformation to unlock operational benefits



ARPU growth driven by provision of additional services

H1 progress

- Growth across all three core channels: consumer, business and wholesale
- Continued demand for fibre services; deployment on track against targets
- Plans agreed to reach remaining 25% of addressable market by March 2019
- Services roadmap, including over-the-top applications, is developing

Enterprise

Growth strategy

IP-based solutions that deliver value through business transformation

- Focus on contact and collaborative space
- Exploit the increasing trend to public cloud
- Leverage growing market for contact centres as a service
- Expand range of markets served which includes
  - Initial focus: contact centre, cloud provider, PaaS, IaaS
  - Medium term focus: security, identity
  - Longer term focus: IoT, big data, machine learning
- Develop relevant vendor relationships
- Strengthen key skills and capability

H1 progress

- Developing relationships with existing customers
    - Growth in top 10 customer accounts
- Contract renewal and expansion with NFUM
- New customer contracts
- Investment in management and key skills capability
- Certain customer contracts holding back overall performance

Financial performance

Jane Aikman

Summary financial results

	H1 FY18 £m	H1 FY17 £m	% Change
Revenue	**151.3**	**165.3**	**(8%)**
EBITDA	**29.8**	**32.0**	**(7%)**
EBITDA %	*20%*	*19%*	
Profit before taxation	**13.6**	**17.7**	**(23%)**
Adjusted basic EPS (pence)*	2.16	2.78	(22%)
Exceptional items	1.2	(1.7)	
Cash capex	18.6	27.1	
Net debt	67.8	45.7	
Interim dividend per share (pence)	2.00p	2.00p	**-**

- Revenue reduction of 8% due to expected decline in legacy business in National Network Services
- Further incurred and anticipated losses of £6.2m in Enterprise complex software contracts affecting EBITDA and PBT
- Exceptional credit due to settlement of regulatory issues (deemed consent) offset by lower restructuring costs
- Net debt of £67.8m, driven by continued investment in HEY infrastructure

All amounts are before exceptional items
** Adjusted basic EPS is basic EPS adjusted for post tax impact of exceptional items*

Segmental performance

	HEY		Enterprise		NNS		Central		Group	
	H1 FY18 £m	**H1 FY17 £m**	**H1 FY18 £m**	**H1 FY17 £m**	**H1 FY18 £m**	**H1 FY17 £m**	**H1 FY18 £m**	**H1 FY17 £m**	**H1 FY18 £m**	**H1 FY17 £m**
Revenue	**51.1**	**50.4**	**43.8**	**43.2**	**58.4**	**73.7**	**(2.0)**	**(2.0)**	**151.3**	**165.3**
Gross margin	**39.6**	**39.3**	**10.2**	**13.4**	**16.1**	**20.4**	**-**	**-**	**65.9**	**73.1**
%	*77%*	*78%*	*23%*	*31%*	*28%*	*28%*	*0%*	*0%*	*44%*	*44%*
Indirect costs	(9.1)	(9.1)	(11.0)	(11.9)	(10.3)	(12.8)	(5.7)	(7.3)	(36.1)	(41.1)
Contribution / EBITDA	**30.5**	**30.2**	**(0.8)**	**1.5**	**5.8**	**7.6**	**(5.7)**	**(7.3)**	**29.8**	**32.0**
%	*60%*	*60%*	*(2%)*	*3%*	*10%*	*10%*			*20%*	*19%*

- Indirect costs reduced by £5.0m (12%) due to actions taken to reduce people costs midway through the prior year
- Reinvestment of some of these savings in H2 will reduce full year benefit

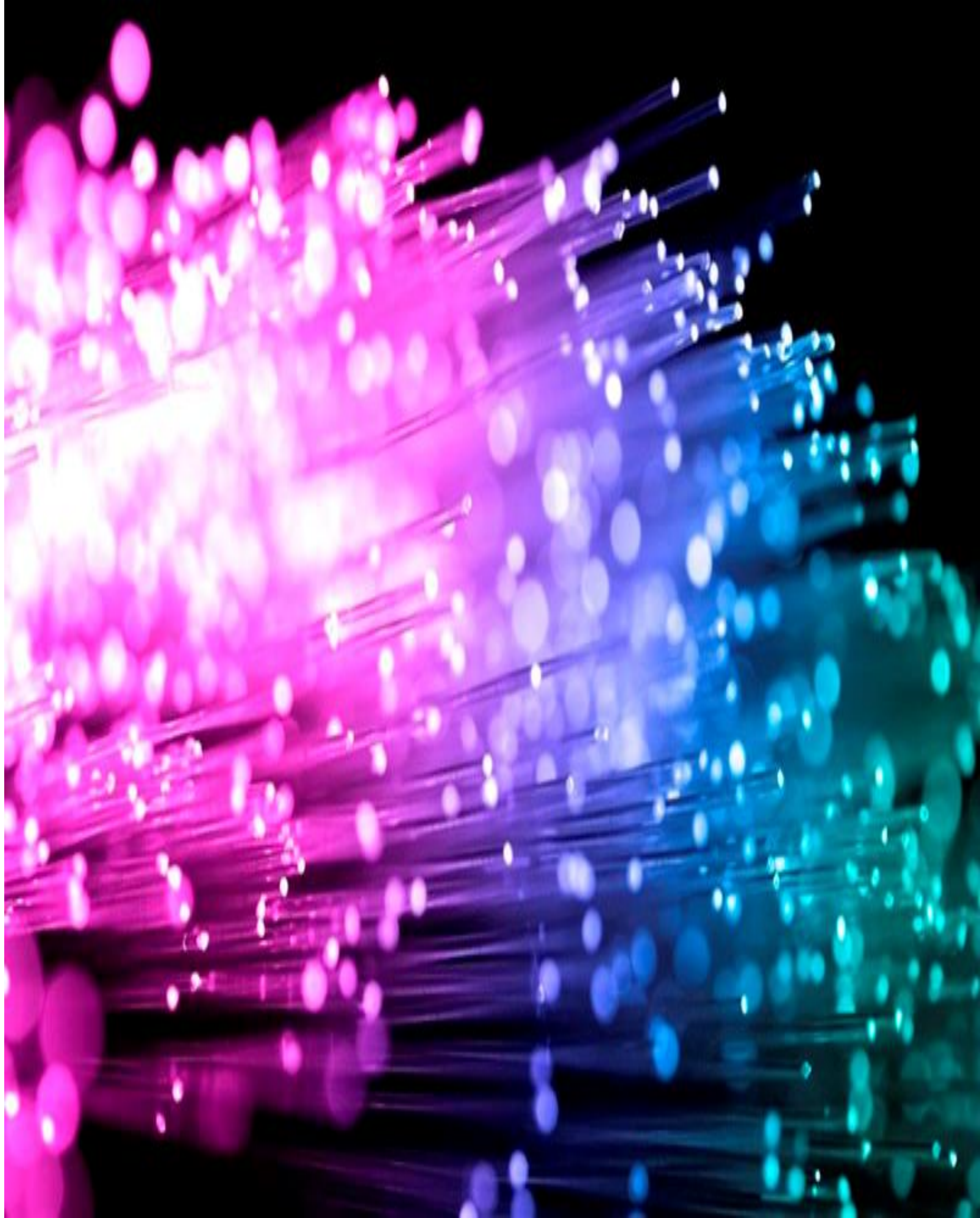
Hull & East Yorkshire

	H1 FY18 £m	H1 FY17 £m	% Change
Revenue			
Consumer	28.8	27.7	4%
Business	14.4	14.3	1%
Wholesale	5.3	5.2	2%
Core business revenue	**48.5**	**47.2**	**3%**
Media	1.2	1.5	(20%)
Contact Centres	1.4	1.7	(18%)
Total revenue	**51.1**	**50.4**	**1%**
Gross margin	**39.6**	**39.3**	**1%**
Gross margin %	*77%*	*78%*	
Contribution	**30.5**	**30.2**	**1%**
Contribution %	*60%*	*60%*	

- Revenue growth of 3% in core channels
- Consumer revenue increase of 4%
  - supported by continued fibre deployment
  - 4% ARPU uplift (to £34.50 per user per month)
- Business and Wholesale growth in connectivity and data, offsetting voice decline
- Anticipated decline in Contact Centres and Media
  - Decision to close Contact Centres - March 2018
- Contribution consistent despite £1m supplier credit in prior year

Fibre deployment progress

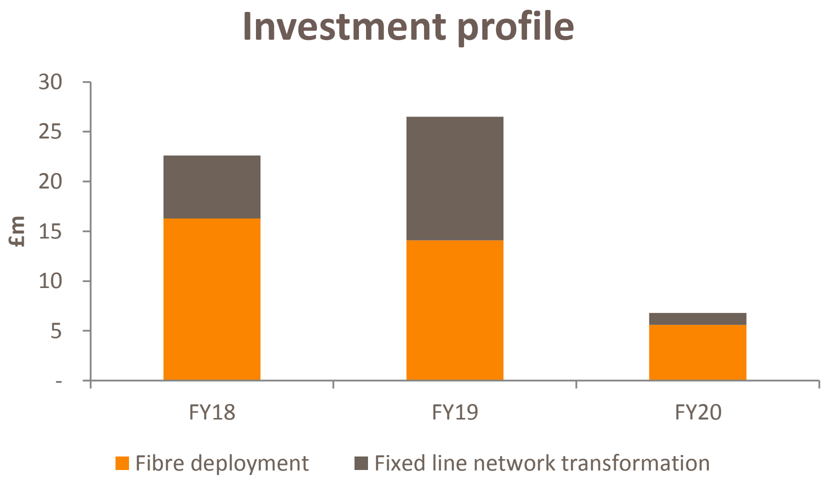
- **Fibre availability**
  - 10k premises passed during H1 FY18, taking total to 147k
  - On target to make fibre available to 150k premises by December 2017
- **Customer connections**
  - Focus is on connecting customers to meet demand
  - 11k premises connected so far in the year
  - Total active customers now 54k, including over 3k businesses
  - 60% of our broadband customers in our fibre-enabled areas are taking a fibre service
- £60m total spend to reach 150k and connect c.60k customers
- Continue to adapt deployment processes to maintain and further improve on previous low cost benchmarks



Investment to drive revenue and save costs

Complete the fibre deployment to provide broadband for data services

- Target to make fibre available to 202k premises by March 2019 and connect a further c.60k premises by March 2020 at a cost of £25m
- All customers will have access to broadband with speeds that exceed regulatory requirement (USO) of 10MB in advance of regulation being effective
- FTTP is the “gold standard” of fibre broadband



Plans to transform the fixed line telephone network

Step 1: Voice over fibre from the exchange – copper remaining from premise to exchange

- Install next generation transmission network to future proof bandwidth requirements – project already underway
- Install software switching and gateway technology to transfer voice from copper network to fibre network from the exchange sites by March 2020 – removes risk and cost of legacy switching equipment
- The proposed approach avoids the need for a forced migration to realise the savings and removes requirement for battery back-up at this stage
- Allows us to review network support contracts
- Cost of c.£26m with recurring annualised capex and opex savings of c.£8-9m (including benefit of reviewing network support contracts) from FY22

Step 2: Remove copper from exchange to premises

- Allows removal of copper and recovery value. Benefits vs costs not yet proved and not included in current investment plans

Enterprise

	H1 FY18 £m	H1 FY17 £m	% Change
Revenue			
Projects	18.3	22.8	(20%)
Managed Service	18.9	14.0	35%
Network	6.6	6.4	3%
Total revenue	**43.8**	**43.2**	**1%**
Gross margin	**10.2**	**13.4**	**(24%)**
Gross margin %	*23%*	*31%*	
Contribution	**(0.8)**	**1.5**	**(153%)**
Contribution %	*(2%)*	*3%*	

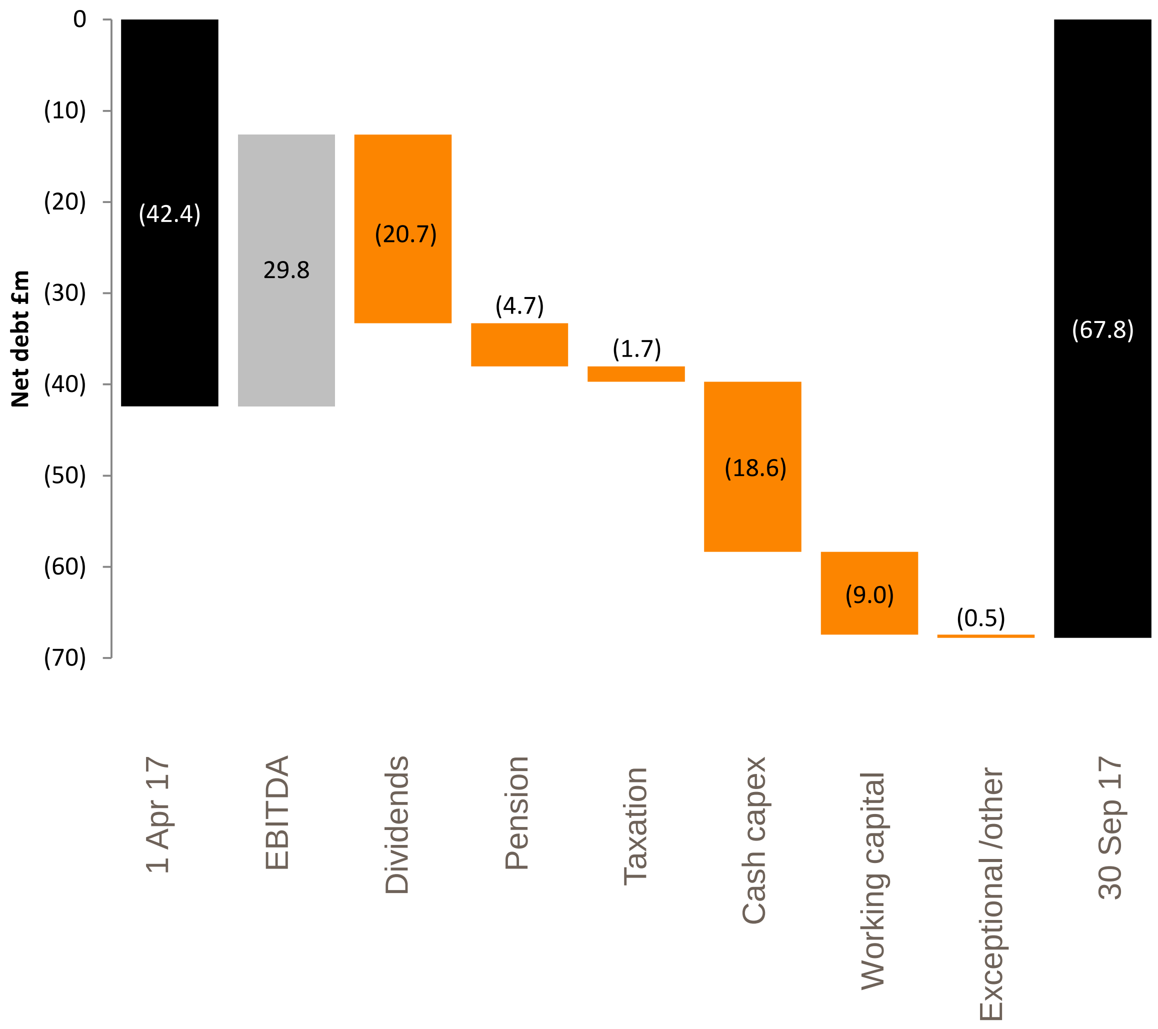
- Revenue growth of 8% from top 10 customers
- Continued to incur losses (£1.7m) on complex software contracts identified at the year end and have recognised anticipated future losses (£4.5m)
- Our relationship with this customer spans over 10 years and remains strong. Proposing to exit one of the contracts. Remaining contracts being reviewed with customer to agree way forward
- Without the effect of these contracts, Enterprise revenue would have grown by 5% with gross margin of 38% and contribution of 12%

National Network Services

	H1 FY18 £m	H1 FY17 £m	% Change
Revenue			
SMB	26.0	26.9	(3%)
Partners	17.4	21.7	(20%)
Large Corporate	15.0	25.1	(40%)
Total revenue	**58.4**	**73.7**	**(21%)**
Gross margin	**16.1**	**20.4**	**(21%)**
Gross margin %	*28%*	*28%*	
Contribution	**5.8**	**7.6**	**(24%)**
Contribution %	*10%*	*10%*	

- Progress with managing churn in the commodity end of the market and driving value and growth in those areas we can add more value
- Focus on providing value in the larger end of SMB market. Growth in managed WAN connectivity services to multi-site organisations has held this channel flat
- Large Corporate revenue declined as expected largely due to prior decision to cease support for certain services
- Partners revenue has declined as a result of anticipated customer churn alongside a decline in intelligent numbering (eg premium rate) due to industry wide decline
- Total revenue is expected to continue to decline over the full year as previously signalled

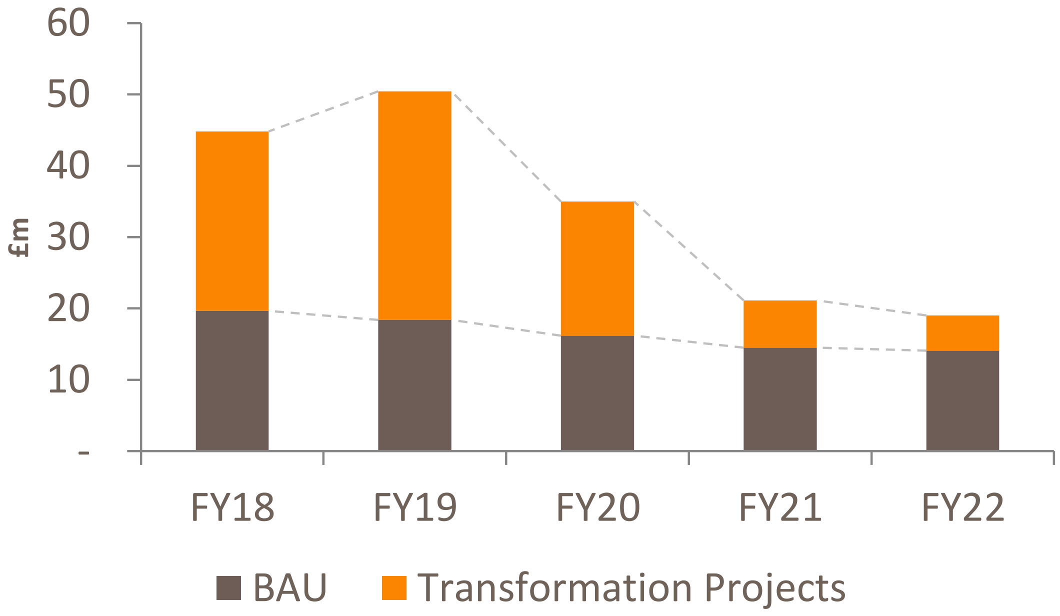
Net debt and cashflow

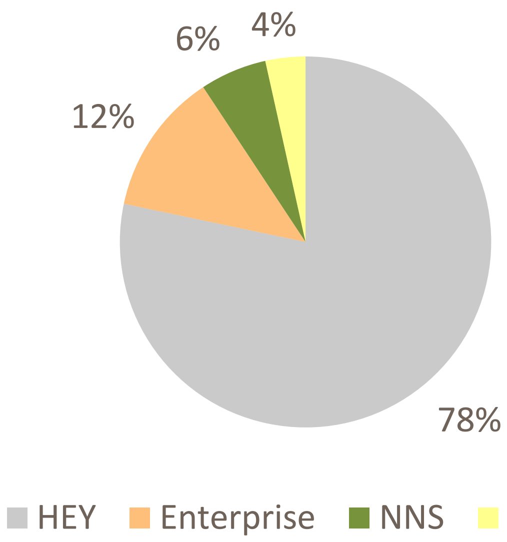


- Net debt of £67.8m
- Increase due to continued investment capex plus H1 working capital outflow
- Working capital outflow mainly mid-year timing which we expect to reverse by year end
  - Reduction in deferred revenue balances on two major customers
  - Timing of invoices relating to rates and capex
  - VAT movements
- Receipts and payments continue to be well controlled:
  - DSO 35 days - improvement from 39 days at September 2016
  - Underlying DPO in line with 30 September 2016 position

Capital investment

- Capital expenditure will remain high for this year and the next two
- Investment focused in HEY on full-fibre broadband and network transformation
- Transformation capex in Enterprise to improve service delivery capability and systems improvements
- Other investment is mainly in central systems and IT transformation
- Business as usual capex expected to reduce to c.£15m from FY20 onwards





Transformation capex by segment

Outlook

- Investment focused on delivering long term sustainable value
- In HEY, complete deployment of the current phase of our fibre plans in H2 and begin to make fibre available to the final 25% of premises in our addressable market
- In Enterprise, investment in management and key skills to generate additional growth in the medium term
- In National Network Services, the decline in legacy services expected to continue in H2
- Expect further progress on strategic initiatives in H2 and remain confident in the medium term prospects for the Group
- Capital Markets Day: 1 February 2018