28 November 2017

KCOM GROUP PLC (KCOM.L)

Unaudited Interim Results for the six months ended 30 September 2017

KCOM Group PLC (KCOM.L) announces its unaudited interim results for the six months ended 30 September 2017.

Key points

- Hull & East Yorkshire revenue increased by 1% compared to first half last year
  - Growth in each of its core channels, 4% revenue growth in Consumer
- Enterprise revenue has grown by 1%
  - Further growth impacted by the UK General election and proposed exit of a previously identified software contract
- Group revenue reduced by 8% driven by expected decline in its legacy activities within National Network Services
- Continued focus on cost base – indirect costs 12% lower than first half last year
- Profit before tax reduced by 8%
  - Expected decline in legacy activities and the impact of the previously identified software contracts in Enterprise, which resulted in the recognition of both incurred losses of £1.7 million and provisions of £4.5 million
  - Ongoing depreciation and amortisation impact of continued investments in Hull & East Yorkshire infrastructure
- On track to make fibre available to the final 25% of premises in Hull & East Yorkshire addressable market by March 2019
- Net debt stands at £67.8 million, driven predominantly by continued capital investment
- Interim dividend of 2.00p, consistent with stated dividend commitment

Financial highlights

	Unaudited six months ended 30 Sept 2017 £'m	Unaudited six months ended 30 Sept 2016 £'m	Change over prior year
Performance measure			
Revenue	**151.3**	165.3	(8.5%)
EBITDA [1,3]	**29.8**	32.0	(6.9%)
Profit before tax [1,3]	**13.6**	17.7	(23.2%)
Adjusted basic earnings per share (pence) [2,3]	**2.16p**	2.78p	(22.3%)
Cash capital expenditure [3]	**18.6**	27.1	(31.4%)
Reported results			
Profit before tax	**14.8**	16.1	(8.1%)
Basic earnings per share (pence)	**2.35p**	2.52p	(6.7%)
Net debt [3]	**67.8**	45.7	48.4%
Interim dividend per share (pence)	**2.00p**	2.00p	-

[1] Before exceptional items
[2] Adjusted basic EPS is basic EPS adjusted for exceptional items (including the tax impact of exceptional items)
[3] For definition and reconciliation to statutory measure see glossary

Bill Halbert, Chief Executive said:

“In the context of today’s economic and political uncertainties, our results demonstrate encouraging progress. Our headline performance was offset by the expected decline in the legacy activities in National Network Services and ongoing issues with previously identified software development contracts within Enterprise.

“In Hull & East Yorkshire, we achieved particularly strong growth in the residential market. The take-up of fibre services across our broadband base has remained robust at 44%. Building on the success of the current fibre investment, we are pleased to announce plans to complete the final stage of this deployment, making fibre available to all premises within our addressable market by March 2019.

“In Enterprise, despite performance having been affected in the first half by the slowdown in government spending caused by the General Election and by continuing issues with the previously identified software development contracts, there was underlying growth alongside new contract wins and renewals.

“The interim dividend is 2.00 pence per share as per our stated commitment, an indication of medium term confidence.”

Outlook

The investments we are making, particularly in Hull & East Yorkshire, will deliver long term sustainable value. We therefore remain confident about our prospects in the medium term.

We will complete the deployment of the current phase of our fibre plans in December and begin to make fibre available to the final 25% of premises in our addressable market. We plan also to start implementing a number of over the top services to monetise further this investment, as we begin to migrate value from infrastructure to services.

In Enterprise, the investment we have made in management and key skills is expected to generate further growth in the medium term.

In National Network Services, we expect the decline in legacy services to continue in the second half. We continue to manage this decline to maximise value for the Group.

The interim dividend of 2.00 pence is in line with current dividend commitment of a minimum full year dividend of 6.00 pence per share, which is in place for the current financial year.

For further information please contact:

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Performance review

Group performance

The results for the period show a decline in both Group revenue and EBITDA, compared to the first half of last year, by 8% and 7% respectively.

Our Hull & East Yorkshire segment has performed well with revenue growth across all three core sales channels. Our fibre deployment is on track and continues to drive higher Average-Revenue-Per-User (ARPU[1]) across our consumer base. The final c.25% of the deployment has been approved and we expect to have fibre available to our whole addressable market by the end of March 2019.

In our Enterprise segment, we have continued to incur losses on the complex software contracts identified at the year end of £1.7 million and have also recognised provisions for future losses of £4.5 million. This has affected adversely both revenue and contribution in the period. Our relationship with the customer spans over 10 years and remains strong. We are proposing to exit one of the contracts and are working through with the customer how best to manage the remaining contracts. Without the effect of these contracts, Enterprise revenue would have grown by 5% with gross margin of 38% and contribution of 12%.

Legacy business in our National Network Services segment continues to decline, as expected, affecting both revenue and contribution.

Indirect costs have reduced by £5.0 million (12%) compared to the first half of last year, largely due to actions taken to reduce our people costs midway through the prior year. Reinvestment of some of these savings in the second half of this year will reduce the overall benefit for the full year.

Exceptional items show a net credit due to a regulatory settlement and a reduction in the level of restructuring costs attributable to business transformation.

Net debt was £67.8 million at 30 September 2017, largely as a result of 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 1. The definition of contribution is set out in the glossary.

[1] Refer to glossary

Hull & East Yorkshire

	Unaudited six months ended 30 Sept 2017 £'m	Unaudited six months ended 30 Sept 2016 £'m	Audited year ended 31 Mar 2017 £'m
Revenue			
Consumer	**28.8**	27.7	56.1
Business	**14.4**	14.3	29.6
Wholesale	**5.3**	5.2	11.0
Sub total	**48.5**	47.2	96.7
Media	**1.2**	1.5	2.4
Contact Centres	**1.4**	1.7	3.2
Total revenue	**51.1**	50.4	102.3
Gross margin	**39.6**	39.3	78.5
Contribution	**30.5**	30.2	60.4

Each of our core sales channels has shown revenue growth. Consumer revenue has increased by 4% compared to the first half of the prior year. Our fibre deployment has enabled us to access more customers, with a net additional 2,000 broadband (ADSL and fibre) customers since 30 September 2016. The number of customers within this broadband base taking a fibre service has increased from 26% to 44% over the same period, supporting a 4% increase in ARPU.

Our Business and Wholesale channels have seen a slight increase in revenue as decreases in traditional fixed voice have been offset by growth in connectivity services and data usage.

As anticipated and signalled previously, our non-core Media and Contact Centres revenue has continued to decline. We intend to close our outsourced Contact Centres in this segment by 31 March 2018, when its largest customer contract comes to an end.

Contribution has increased compared to the prior period, despite those results including a one off supplier credit (£1 million).

The success of our ultra-fast Fibre-to-the-Premise (FTTP) offering continues. Our deployment is ahead of target and as stated previously we expect to pass 150,000 premises (approximately three quarters of our addressable market) before the end of December 2017. We plan to pass the remaining c.25% of premises in our addressable market by March 2019.

During the period we have passed a further 10,000 premises, taking our total to 147,000. Take-up remains strong with 11,000 premises connected in the half, taking the total connected to 54,000 (including 3,000 businesses). Across our fibre-enabled areas, 60% of our broadband customers are taking a fibre service.

Enterprise

	Unaudited six months ended 30 Sept 2017 £'m	Unaudited six months ended 30 Sept 2016 £'m	Audited year ended 31 Mar 2017 £'m
Revenue			
Projects	**18.3**	22.8	48.3
Managed Service	**18.9**	14.0	30.5
Network	**6.6**	6.4	12.2
Total revenue	**43.8**	43.2	91.0
Gross margin	**10.2**	13.4	25.6
Contribution	**(0.8)**	1.5	4.5

Revenue for the first half of the year has increased by 1% compared to the first half of the prior year. The growth rate has been affected by the unexpected UK General election and its effect on public sector spending, alongside the proposed exit of one of the complex software contracts identified at the year end.

We have continued to see successful relationships with key customers such as HMRC and NFUM and our brand and reputation in this segment is continuing to strengthen. Revenue from our top 10 customers has grown by 8% compared to the first half of last year. In the period we signed a number of new names including Interdigital, SES Water and ITSO and renewed and extended our contract with NFUM, demonstrating our ability to build and expand customer relationships.

We have continued to incur losses on the software development contracts identified at the year end of £1.7 million and have also recognised a provision for future losses of £4.5 million. This has affected adversely both revenue and contribution in the period. Our relationship with this customer spans over 10 years and remains strong. We are proposing to exit one of the contracts and are working through with the customer how best to manage the remaining contracts. Without the effect of these contracts, Enterprise revenue would have grown by 5% with gross margin of 38% (30 September 2016: 33%) and contribution of 12% (30 September 2016: 5%).

National Network Services

	Unaudited six months ended 30 Sept 2017 £'m	Unaudited six months ended 30 Sept 2016 £'m	Audited year ended 31 Mar 2017 £'m
Revenue			
SMB	**26.0**	26.9	52.6
Partners	**17.4**	21.7	41.8
Large Corporate	**15.0**	25.1	47.4
Total revenue	**58.4**	73.7	141.8
Gross margin	**16.1**	20.4	41.0
Contribution	**5.8**	7.6	16.0

As anticipated, we have seen a decrease in revenue compared to the first half of the prior year. The majority of this decline has come from large corporate customers taking legacy services which we took the decision to stop supporting in previous years. Strong cost control has led to a contribution margin percentage consistent with the first half of the prior year.

During the period, we have continued to focus on the larger end of the mid-market (SMB), where we can provide more value, with continued growth in managed wide area network (WAN) connectivity services to multi-site organisations, including the deployment to 900 retail convenience stores nationally for One Stop Stores.

Central

Central costs include PLC and corporate costs, where allocation to the underlying segments would not improve understanding of those segments. These costs include share-based payments and pensions, along with the residual Group cost of finance, HR, risk, legal and communications, once appropriate recharges have been made to the three business segments.

Central costs have decreased from £7.2 million (six months ended 30 September 2016) to £5.7 million largely as a result of actions taken to reduce people and other costs.

Exceptional items

The Group benefitted from a net exceptional credit of £1.2 million in the first six months of the year. This comprises:

- a credit of £1.9 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 inadequately and retrospectively applying Deemed Consent; offset by
- restructuring costs of £0.7 million relating to one off redundancy costs as we continue to re-shape the business.

Net debt and cash flow

Net debt at 30 September 2017 is £67.8 million (30 September 2016: £45.7 million), representing a net debt to EBITDA ratio of 1.0x.

The increase in net debt compared to the year end position arises as a result of continued investment in our fibre deployment along with a working capital outflow. As in the prior year, much of the working capital movement relates to timing which we expect to unwind in the second half of the year.

Underlying working capital continues to be well controlled. Days Sales' Outstanding (35) is an improvement on the 30 September 2016 position (39) and our Days' Purchases Outstanding remains consistent with the 30 September 2016 position.

Dividend

The Group's interim dividend is 2.00 pence per share (30 September 2016: 2.00 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 9 February 2018 to shareholders registered on 29 December 2017. The ex-dividend date is 28 December 2017.

Pensions

The IAS 19 pension position at 30 September 2017 is a (net) liability of £3.7 million (30 September 2016: £44.1 million liability and 31 March 2017: £19.7 million liability). The decrease from 31 March 2017 arises as a result of a higher discount rate used to calculate the schemes' liabilities (driven by increases in corporate bond yields) alongside a strong asset performance.

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

Capital investment

Cash capital expenditure during the period was £18.6 million (30 September 2016: £27.1 million), consistent with previous guidance. The major project in the period was the continued deployment of fibre in Hull & East Yorkshire.

The Group's depreciation and amortisation charge for the period is £15.1 million (30 September 2016: £13.2 million), the increase resulting from the higher capital investment in recent years, which has an ongoing impact on profit before tax.

Tax

The Group's tax charge is £2.8 million (30 September 2016: £3.2 million). The effective tax rate is 19%, in line with the prevailing rate of corporation tax of 19%.

Principal risks and uncertainties

The Group has a number of risks and uncertainties which have been identified through the risk management framework. The risks set out below could have a material adverse impact on the Group:

- growing revenue in our Enterprise segment to offset the decline of network-based revenue – revenue from legacy activities may decline faster than the revenue from new services grows;
- substitute technologies entering the consumer market – the development of substitute technologies without the need for a fixed line could present a competitive threat within the consumer part of our business;
- upgrading of our network equipment – our equipment requires upgrading as demand for broadband and cloud-based services increases;
- accuracy, security and confidentiality of customer data – security of customer data is of paramount importance to our customers and therefore to us;
- customer service, contract governance and delivery – the delivery of our complex contracts is a key part of the success our Enterprise segment and providing exceptional service to our customers is one of our key strategic aims. Failure to govern contracts sufficiently may have reputational or financial impact.
- security and resilience of our networks and IT systems – our networks and IT systems are key to all that we do and are crucial in delivering service to our customers;
- a breach of our regulatory obligations – we take our regulatory responsibilities extremely seriously and seek to ensure we are compliant;
- health and safety – it is important to mitigate health and safety risks as far as possible to prevent incidents from occurring; and
- flooding – flooding (particularly in Hull) has become an increasingly regular occurrence and could impact our business if we don’t take appropriate steps to mitigate the risks.

More detail of the Group’s risks are shown on pages 26 to 29 of the Annual report and accounts for the year ended 31 March 2017 and it is the view of the directors that these risks and uncertainties remain appropriate for this interim statement.

Forward looking statements

Certain statements in this interim statement are forward looking. Although the Group believes that the expectations reflected in these forward looking statements are reasonable, we can give no assurance that these expectations will prove to be correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward looking statements.

We undertake no obligation to update any forward looking statements whether as a result of new information, future events or otherwise.

Consolidated interim income statement

	Notes	**Unaudited six months ended 30 Sept 2017 £'000**	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Revenue		**151,308**	165,326	331,303
Operating expenses		**(135,420)**	(148,122)	(298,547)
Operating profit		**15,888**	17,204	32,756
Finance costs	3	**(1,070)**	(1,149)	(2,263)
Share of profit of associates		**7**	12	12
Profit before tax	1	**14,825**	16,067	30,505
Tax	4	**(2,803)**	(3,234)	(5,743)
Profit for the period attributable to owners of the parent		**12,022**	12,833	24,762

Operating profit analysed as:				
EBITDA before exceptional items	1	**29,780**	32,041	67,645
Exceptional credits	2	**1,918**	-	-
Exceptional charges	2	**(715)**	(1,671)	(7,981)
Depreciation of property, plant and equipment		**(7,971)**	(7,149)	(14,279)
Amortisation of intangible assets		**(7,124)**	(6,017)	(12,629)
Operating profit		**15,888**	17,204	32,756

Earnings per share (pence)				
Basic	5	**2.35**	2.52	4.85
Diluted	5	**2.33**	2.49	4.81

Consolidated interim statement of comprehensive income

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Profit for the period	**12,022**	12,833	24,762
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Remeasurements of retirement benefit obligations	**12,061**	(33,887)	(12,035)
Tax on items that will not be reclassified	**(2,172)**	6,019	1,738
Total items that will not be reclassified to profit or loss	**9,889**	(27,868)	(10,297)
Total comprehensive income/(expense) for the period attributable to owners of the parent	**21,911**	(15,035)	14,465

Consolidated interim balance sheet

	Notes	**Unaudited as at 30 Sept 2017 £'000**	Unaudited as at 30 Sept 2016 £'000	Audited as at 31 Mar 2017 £'000
Assets				
Non-current assets				
Goodwill		**51,372**	51,372	51,372
Other intangible assets		**43,380**	47,004	45,709
Property, plant and equipment		**110,915**	100,886	106,323
Investments		**52**	61	45
Retirement benefit asset	7	**3,078**	-	-
Deferred tax assets		**4,530**	12,295	7,836
		213,327	211,618	211,285
Current assets				
Inventories		**3,572**	5,053	3,075
Trade and other receivables		**64,252**	77,606	68,406
Cash and cash equivalents	8	**9,521**	16,660	16,093
		77,345	99,319	87,574
Total assets		**290,672**	310,937	298,859
Liabilities				
Current liabilities				
Trade and other payables		**(95,333)**	(113,143)	(110,917)
Current tax liabilities		**-**	(2,419)	-
Bank overdrafts	8	**(684)**	(2,699)	(5,903)
Finance leases	8	**(1,846)**	(2,587)	(1,942)
Provisions for other liabilities and charges		**(295)**	(297)	(377)
Non-current liabilities				
Bank loans	8	**(73,679)**	(54,133)	(48,587)
Retirement benefit obligations	7	**(6,821)**	(44,076)	(19,691)
Deferred tax liabilities		**(7,135)**	(6,037)	(7,498)
Finance leases	8	**(1,116)**	(2,944)	(2,094)
Provisions for other liabilities and changes		**(1,858)**	(2,171)	(1,962)
Total liabilities		**(188,767)**	(230,506)	(198,971)
Net assets		**101,905**	80,431	99,888
Equity				
Capital and reserves, attributable to owners of the parent				
Share capital		**51,660**	51,660	51,660
Share premium account		**353,231**	353,231	353,231
Accumulated losses[1]		**(302,986)**	(324,460)	(305,003)
Total equity		**101,905**	80,431	99,888

[1] Included within accumulated losses for the six months ended 30 September 2017 is a profit after tax of £12.0 million.

Consolidated interim statement of changes in shareholders' equity

	Notes	Share capital £'000	Share premium account £'000	Accumulated losses £'000	Total £'000
At 1 April 2016 (audited)		51,660	353,231	(288,624)	116,267
Profit for the period		-	-	12,833	12,833
Other comprehensive income		-	-	(27,868)	(27,868)
Total comprehensive income for the period ended 30 September 2016 (unaudited)		-	-	(15,035)	(15,035)
Deferred tax charge relating to share schemes		-	-	(102)	(102)
Deferred tax credit relating to asset-backed Partnership		-	-	262	262
Purchase of ordinary shares		-	-	(1,310)	(1,310)
Employee share schemes		-	-	703	703
Dividends	6	-	-	(20,354)	(20,354)
				(20,801)	(20,801)
At 30 September 2016 (unaudited)		51,660	353,231	(324,460)	80,431
Profit for the period		-	-	11,929	11,929
Other comprehensive income		-	-	17,571	17,571
Total comprehensive income for the period ended 31 March 2017 (audited)		-	-	29,500	29,500
Deferred tax charge relating to share schemes		-	-	(20)	(20)
Deferred tax charge relating to asset-backed Partnership		-	-	(262)	(262)
Purchase of ordinary shares		-	-	(468)	(468)
Employee share schemes		-	-	1,039	1,039
Dividends	6	-	-	(10,332)	(10,332)
				(10,043)	(10,043)
At 31 March 2017 (audited)		51,660	353,231	(305,003)	99,888
Profit for the period		-	-	12,022	12,022
Other comprehensive income		-	-	9,889	9,889
Total comprehensive income for the period ended 30 September 2017 (unaudited)		-	-	**21,911**	**21,911**
Deferred tax credit relating to share schemes		-	-	3	3
Purchase of ordinary shares		-	-	(150)	(150)
Employee share schemes		-	-	917	917
Dividends	6	-	-	(20,664)	(20,664)
		-	-	(19,894)	(19,894)
At 30 September 2017 (unaudited)		**51,660**	**353,231**	**(302,986)**	**101,905**

Consolidated interim cash flow statement

	Notes	**Unaudited six months ended 30 Sept 2017 £'000**	Unaudited six months ended 30 Sept 2016 £'000	Audited Year ended 31 Mar 2017 £'000
Cash flows from operating activities				
Operating profit		**15,888**	17,204	32,756
Adjustments for:				
- depreciation and amortisation		**15,095**	13,166	26,908
- increase in working capital		**(12,513)**	(26,872)	(18,302)
- (Profit)/loss on sale of property, plant and equipment		**(15)**	69	555
- non-employee-related pension charges		**625**	316	655
- Share based payment charge		**917**	703	1,742
Payments made to defined benefit pension schemes		**(4,732)**	(4,697)	(7,724)
Tax paid		**(1,706)**	(4,872)	(8,019)
Net cash generated from/(used in) operations	8	**13,559**	(4,983)	28,571
Cash flows from investing activities				
Purchase of property, plant and equipment		**(12,133)**	(16,211)	(28,403)
Purchase of intangible assets		**(5,388)**	(9,381)	(15,792)
Proceeds from sale of property, plant and equipment	8	**53**	-	68
Net cash used in investing activities		**(17,468)**	(25,592)	(44,127)
Cash flows from financing activities				
Dividends paid	6	**(20,664)**	(20,354)	(30,686)
Interest paid	8	**(516)**	(534)	(1,257)
Capital element of finance lease repayments		**(1,114)**	(1,479)	(3,025)
Payment of loan issue costs		**-**	-	(720)
Repayment of bank loans		**(20,000)**	(5,000)	(15,000)
Drawdown of bank loans		**45,000**	60,000	65,000
Purchase of ordinary shares	8	**(150)**	(1,309)	(1,778)
Net cash generated from financing activities		**2,556**	31,324	12,534
(Decrease)/increase in cash and cash equivalents		**(1,353)**	749	(3,022)
Cash and cash equivalents at the beginning of the period		**10,190**	13,212	13,212
Cash and cash equivalents at the end of the period	8	**8,837**	13,961	10,190

Notes to the unaudited interim financial information

1. Segmental analysis

The Group's operating 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.

The Board considered three "go to market" segments, Hull & East Yorkshire, Enterprise and National Network Services, along with a Central segment. These segments are consistent with those presented in our Annual report and accounts for the year ended 31 March 2017. In the second half of the year ended 31 March 2017 our operating segments were refined to align with the way the business is run and the financial analysis performed. Our segmental results for the period ended 30 September 2016 are represented on this basis.

Contribution represents gross margin less all costs directly attributable to the segment. As disclosed in our Annual report and accounts for the year ended 31 March 2017, KCOM Group PLC continues to have one business-wide EBITDA with segment profitability (contribution) used as the metric of reporting segmental performance.

	Revenue			**Contribution**		
	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000	**Unaudited six months ended 30 Sept 2017 £'000**	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Before exceptional items						
Hull & East Yorkshire	**51,057**	50,365	102,275	**30,507**	30,205	60,424
Enterprise	**43,847**	43,199	90,966	**(813)**	1,462	4,500
National Network Services	**58,439**	73,706	141,811	**5,806**	7,620	15,959
Central	**(2,035)**	(1,944)	(3,749)	**(5,720)**	(7,246)	(13,238)
Total before exceptional items	**151,308**	165,326	331,303	**29,780**	32,041	67,645
Exceptional items						
Hull & East Yorkshire	**-**	-	-	**(109)**	(237)	(2,338)
Enterprise	**-**	-	-	**(91)**	(234)	(2,624)
National Network Services	**-**	-	-	**1,735**	(67)	353
Central	**-**	-	-	**(332)**	(1,133)	(3,372)
Total	**-**	-	-	**1,203**	(1,671)	(7,981)
Total after exceptional items	**151,308**	165,326	331,303	**30,983**	30,370	59,664

Notes to the unaudited interim financial information continued

1. Segmental analysis continued

A reconciliation of EBITDA to total profit before tax is provided as follows:

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
EBITDA post exceptional items	**30,983**	30,370	59,664
Depreciation	**(7,971)**	(7,149)	(14,279)
Amortisation	**(7,124)**	(6,017)	(12,629)
Finance costs	**(1,070)**	(1,149)	(2,263)
Share of profit of associates	**7**	12	12
Profit before tax	**14,825**	16,067	30,505

The split of total revenue between external customers and inter-segment revenue is as follows:

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Revenue from external customers			
Hull & East Yorkshire	**49,022**	48,083	97,921
Enterprise	**43,847**	43,199	90,966
National Network Services	**58,439**	73,706	141,811
Central	**-**	338	605
Total	**151,308**	165,326	331,303
Inter-segment revenue			
Hull & East Yorkshire	**2,035**	2,282	4,354
Central	**(2,035)**	(2,282)	(4,354)
Total	**-**	-	-
Group total	**151,308**	165,326	331,303

2. Exceptional items

Exceptional items are separately disclosed by virtue of their size or incidence to improve the understanding of the Group's financial performance.

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
- Regulatory matters	**(1,918)**	-	-
Credited to income statement	**(1,918)**	-	-
- Restructuring costs	**715**	1,671	7,271
- Regulatory matters	**-**	-	710
Charged to income statement	**715**	1,671	7,981
Net (credit)/charge to income statement	**(1,203)**	1,671	7,981

2. Exceptional items continued

Regulatory matters includes a credit of £1.9 million for an industry wide settlement from BT Openreach relating to Deemed Consent. The Ofcom determined settlement arose as a result of a breach in BT Openreach's contractual and regulatory obligations relating to compensation for inadequately and retrospectively applying Deemed Consent.

In the year ended 31 March 2017, the Group incurred costs of £0.7 million in relation to regulatory matters which principally related to a notification from Ofcom stating that KCOM may have failed to comply fully with a required "General Condition" between 2009 and 2015. Ofcom completed its investigation in August 2017 and a settlement was made.

As part of our continued transformation, the Group incurred £0.7 million of redundancy costs during the period. In line with our accounting policy these costs have been shown as restructuring costs within exceptional items. In the year ended 31 March 2017, £7.3 million of costs were incurred in relation to restructuring (of which £3.4 million related to redundancy costs).

The tax charge on exceptional items is £0.2 million. The cash flow impact of exceptional items is a cash outflow of £1.8 million. The difference between the cash flow impact and the charge for the period is due to the timing of cash payments and receipts.

3. Finance costs

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Bank loans, overdrafts and other loans	**593**	527	1,195
Retirement benefit obligations	**220**	220	375
Finance lease and hire purchase contracts	**40**	58	110
	853	805	1,680
Amortisation of loan arrangement fees	**217**	344	583
Total	**1,070**	1,149	2,263

4. Tax

Taxes on income in interim periods are accrued using the tax rate that would be applicable to the expected total annual earnings. The Group's effective rate is 19.0% (2016: 20.1%).

Notes to the unaudited interim financial information continued

5. Earnings per share

	Unaudited six months ended 30 Sept 2017 Number	Unaudited six months ended 30 Sept 2016 Number	Audited year ended 31 Mar 2017 Number
Weighted average number of shares			
For basic earnings per share	**510,987,620**	510,141,695	510,384,583
Share options in issue	**5,327,084**	4,490,038	4,643,349
For diluted earnings per share	**516,314,704**	514,631,733	515,027,932
	£'000	£'000	£'000
Earnings			
Profit attributable to equity holders of the company	**12,022**	12,833	24,762
Adjustments:			
Exceptional items	**(1,203)**	1,671	7,981
Tax on exceptional items	**229**	(334)	(1,596)
Adjusted profit attributable to equity holders of the company	**11,048**	14,170	31,147
	Pence	Pence	Pence
Earnings per share			
Basic	**2.35**	2.52	4.85
Diluted	**2.33**	2.49	4.81
Adjusted basic	**2.16**	2.78	6.10
Adjusted diluted	**2.14**	2.75	6.05

6. Dividends

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Final dividend for the year ended 31 March 2016 of 3.94 pence per share	**-**	20,354	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**	-	-
Total	**20,664**	20,354	30,686

The proposed interim dividend for the six months ended 30 September 2017 is 2.00 pence per share. 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.

Notes to the unaudited interim financial information continued

7. Retirement benefit obligations

The net post-retirement scheme deficit as at 30 September 2017 is calculated on a year to date basis, using the most recent formal triennial actuarial valuation for 31 March 2016, updated to the 30 September 2017.

The Group operates two schemes; Kingston Communications Pension Scheme and Kingston Communications (Data) Pension Scheme referred to in this disclosure as the main scheme and the data scheme respectively.

Movement in the net post-retirement position recognised in the balance sheet were as follows:

Reconciliation of funded status to balance sheet

	Main Scheme £'000	Data Scheme £'000	Total £'000
At 1 April 2017 (audited)	**(12,690)**	**(7,001)**	**(19,691)**
Net finance costs	(139)	(81)	(220)
Net administrative expenses	(343)	(282)	(625)
Contributions by employer	1,197	163	1,360
Deficit repair payments	2,248	1,124	3,372
Remeasurements of retirement benefit obligations	12,805	(744)	12,061
At 30 September 2017 (unaudited)	**3,078**	**(6,821)**	**(3,743)**

Comprised of:

	Main Scheme £'000	Data Scheme £'000	Total £'000
At 30 September 2017 (unaudited)			
Present value of defined benefit obligations	(223,341)	(40,189)	(263,530)
Fair value of plan assets	226,419	33,368	259,787
Surplus/(deficit)	**3,078**	**(6,821)**	**(3,743)**
At 31 March 2017 (audited)			
Present value of defined benefit obligations	(229,723)	(41,506)	(271,229)
Fair value of plan assets	217,033	34,505	251,538
Deficit	**(12,690)**	**(7,001)**	**(19,691)**

Main financial assumptions:

	Unaudited six months ended 30 Sept 2017 %	Unaudited six months ended 30 Sept 2016 %	Audited year ended 31 Mar 2017 %
RPI Inflation	**3.15**	3.00	3.15
CPI Inflation	**2.15**	2.00	2.15
Rate of increase to pensions in payment	**2.20**	2.00	2.20
Discount rate for scheme liabilities	**2.60**	2.15	2.50

Notes to the unaudited interim financial information continued

8. Movement in net (debt)/funds

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Opening net (debt)/funds	**(42,433)**	7,412	7,412
Closing net debt	**(67,804)**	(45,703)	(42,433)
Increase in the period	**(25,371)**	(53,115)	(49,845)
Reconciliation of movement in the period			
Net cash flow from operations	**13,559**	(4,983)	28,571
Cash capital expenditure[1]	**(18,635)**	(27,071)	(47,220)
Proceeds on sale of property, plant and equipment	**53**	-	68
Interest	**(516)**	(534)	(1,257)
Payment of loan issue costs	**-**	-	(720)
Dividends	**(20,664)**	(20,354)	(30,686)
Purchase of ordinary shares	**(150)**	(1,309)	(1,778)
Finance leases[2]	**1,074**	1,420	2,915
Non cash movement in loan arrangement fees	**(92)**	(271)	-
Other	**-**	(13)	262
Increase in the period	**(25,371)**	(53,115)	(49,845)

[1] For definition of cash capital expenditure see glossary
[2] Represents the movement in finance lease liabilities during the period

Net debt comprises:

	Unaudited six months ended 30 Sept 2017 £'000	Unaudited six months ended 30 Sept 2016 £'000	Audited year ended 31 Mar 2017 £'000
Cash and cash equivalents (including bank overdrafts)	**8,837**	13,961	10,190
Bank loans (net of debt issue costs)	**(73,679)**	(54,133)	(48,587)
Finance leases	**(2,962)**	(5,531)	(4,036)
Total net debt	**(67,804)**	(45,703)	(42,433)

9. Basis of preparation and publication of unaudited interim results

General information

KCOM Group PLC is a company domiciled in the United Kingdom.

The Group has its primary listing on the London Stock Exchange. Details of the principal activities of the Group are disclosed on pages 4 to 5 and in the Strategic report in the Group's 2017 Annual report and accounts.

This condensed consolidated interim financial information was approved for issue on 28 November 2017.

This condensed consolidated interim financial information does not comprise statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 March 2017 were approved by the Board of directors on 9 June 2017 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified, did not contain an emphasis of matter paragraph and did not contain any statement under section 498 of the Companies Act 2006.

The condensed consolidated interim financial information has been reviewed, not audited. The review opinion is disclosed on page 26.

This condensed consolidated interim financial information will be published on the Company's website. The maintenance and integrity of the website is the responsibility of the directors. The work carried out by the auditors does not involve consideration of these matters. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Basis of preparation

This condensed consolidated interim financial information for the six months ended 30 September 2017 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (previously Financial Services Authority) and with IAS 34, 'Interim financial reporting' as adopted by the European Union. The condensed consolidated interim financial information should be read in conjunction with the annual financial statements for the year ended 31 March 2017, which have been prepared in accordance with IFRSs as adopted by the European Union.

Going concern

The Group meets its day-to-day working capital requirements through its bank facilities. The Group's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Group should be able to operate within the level of its current facilities. After making enquires, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going concern basis in preparing its consolidated interim financial information.

10. Accounting policies

The accounting policies adopted are consistent with those published in the Group's Annual report and accounts for the year ended 31 March 2017, in Note 2 on pages 85 to 91, except as described below.

Tax policy

Taxes on income in interim periods are accrued using the tax rate that would be applicable to the expected total annual earnings.

11. Significant judgements and estimates

In preparing this condensed consolidated interim financial information, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the Group's Annual report and accounts for the year ended 31 March 2017, in Note 3 on page 91, with the exception of changes in estimates that are required in determining the provision for income taxes (see Note 10).

The preparation of interim financial information requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these judgements and estimates.

In particular, the Group, enters into significant contracts with customers, which include both a 'project' and an 'in-life service'. Revenue relating to the 'project' 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 in order to separate the contract into the two phases. The Directors are also required to make judgements relating to the stage of completion of the installation phase, which includes estimating the work necessary to complete the phase. On the previously identified software contracts in our Enterprise segment, we recognise that material uncertainty exists around certain judgements. Whilst this could reduce the size of anticipated losses, there is also potential for an increase in the Group's exposure.

12. Adoption of new accounting standards

There were no new standards, amendments or interpretations that were adopted by the Group and effective for the first time for the financial period beginning after 1 April 2017 that were material to the Group.

A number of new standards, interpretations and amendments have been issued by the IASB but had either not been adopted by the European Union or were not yet effective in the European Union at 30 September 2017. Three of these new standards are expected to have an impact on the Group financial statements:

IFRS 9 "Financial instruments"

IFRS 9 is applicable to the Group for the year ended 31 March 2019 and covers the classification, measurement, impairment and de-recognition of financial assets and liabilities together with a new hedge accounting model. We have completed our assessment of this new standard and expect the impact to be immaterial.

IFRS 15 "Revenue from contracts with customers"

IFRS 15 sets out the principles for recognising revenue from contracts with customers and will require the Group to use a five step approach to allocate the revenue earned from contracts to individual performance obligations on a relative standalone selling price basis.

This new standard will be applicable to the Group for the year ended 31 March 2019. As disclosed in our Annual report and accounts for the year ended 31 March 2017, we intend to adopt IFRS 15 using the modified retrospective transition method. Consequently, an adjustment will be made to equity at the date of transition (1 April 2018) to recognise the full cumulative impact of applying this standard retrospectively. Currently, we are in the process of completing our detailed assessment and quantifying the impact which will arise from the application of this standard.

12. Adoption of new accounting standards continued

IFRS 16 "Leases"

IFRS 16 replaces IAS 17 "Leases" and will primarily change lease accounting for lessees. Lessor accounting under IFRS 16 is expected to be similar to IAS 17.

For lessees, an operating lease arrangement 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 new standard will be applicable to the Group for the year ended 31 March 2020. The Group is continuing to assess the impact of IFRS 16, which is expected to have an impact on the consolidated income statement and the consolidated balance sheet. We are yet to quantify this impact.

13. Financial risk management and financial instruments

Financial risk factors

The Group's activities expose it to a variety of financial risks; currency risk, interest-rate risk, liquidity risk, and credit risk. The Group's overall risk management strategy is approved by the Board and implemented and reviewed by senior management. Detailed financial risk management is then delegated to the Finance departments which have a specific policy manual that sets out guidelines to manage financial risk. The condensed interim financial information do not include all financial risk management information and disclosures required in the annual financial statements; they should be read in conjunction with the Group's annual financial statements as at 31 March 2017. There have been no changes in the Group's risk management processes or policies since the year end.

Financial instruments

The Group accounts for financial instruments in accordance with IFRS 13. This standard requires disclosure of fair value measurements by level of the following hierarchy;

1. Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
2. 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)
3. Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

Consistent with the March 2017 year end, all of the Group's financial instruments fall into hierarchy level 2. The fair value of financial assets and liabilities is obtained from third party sources.

14. Related party transactions

There are no material related party transactions.

Notes to the unaudited interim financial information continued

15. Statement of directors' responsibilities

The directors confirm that this condensed interim financial information has been prepared in accordance with IAS 34 as adopted by the European Union and the guidance set out in the Accounting Standards Board's 2007 Statement Half-Yearly Reports.

The directors also confirm that the interim management report herein includes a fair review of the information required by DTR 4.2.7R and DTR 4.2.8R, namely:

- an indication of important events that have occurred during the first six months and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related party transactions in the first six months and any material changes in the related party transactions described in the Group's 2017 Annual report and accounts.

The directors of KCOM Group PLC are listed in the KCOM Group Annual report and accounts for the year ended 31 March 2017.

Signed by Order of the Board on 28 November 2017 by:

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.

APM	**Definition and reason for use**	**Reconciliation to equivalent IFRS measure of performance**
EBITDA before exceptional items	Operating profit before finance costs, taxation, depreciation, amortisation and exceptional items. This measure is reflective of the underlying operating performance of the Group. We believe this measure is useful and necessary to analyse performance.	A reconciliation of this measure is provided in Note 1 of these results.
Contribution	An equivalent measure to ‘EBITDA before exceptional items’ for each of the Group’s segments. This metric is used by the Board to compare performance across segments.	A reconciliation of this measure is provided in Note 1 of these results.
Profit before tax before exceptional items	Profit attributable to the shareholders before taxation and exceptional items. This measure is reflective of the overall underlying performance of the Group. We believe this measure is useful and necessary to analyse performance.	Reported in the consolidated income statement: Profit before tax (£14.8m), less exceptional credits (£1.9m), plus exceptional charges of (£0.7m).
Adjusted earnings per share	This shows EPS based upon profit for the period which has been adjusted for exceptional items. This provides additional information regarding earnings per share attributable to the underlying activities of the business.	A reconciliation of this measure is provided in Note 5 of these results.
Net debt	Net debt is cash and cash equivalents, bank overdrafts, finance leases (current and non-current) and bank loans. Reported net debt allows management to assess available funds. 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.	A reconciliation of this measure is provided in Note 8 of these results.

Glossary continued

Alternative Performance Measures continued

APM	**Definition and reason for use**	**Reconciliation to equivalent IFRS measure of performance**
ARPU	Average revenue per user. This measure is specifically used when analysing the consumer performance within the Hull & East Yorkshire segment. This is an important measure for assessing the success of our consumer market.	As ARPU values are not disclosed within these financial statements a reconciliation is not deemed necessary.
Cash capital expenditure	Cash outflow for the purchase of ‘property, plant and equipment’ and ‘other intangible assets’. 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.	Reported in the consolidated cash flow: Purchase of property, plant and equipment (£12.1m) plus Purchase of intangible assets (£5.4m) plus Capital element of finance lease repayments (£1.1m).

Independent review report to KCOM Group PLC

Report on the interim financial information

Our conclusion

We have reviewed KCOM Group PLC's interim financial information (the "interim financial information") in the half-yearly report of KCOM Group PLC for the 6 month period ended 30 September 2017. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements, comprise:

- the Consolidated interim balance sheet as at 30 September 2017;
- the Consolidated interim income statement and Consolidated interim statement of comprehensive income for the period then ended;
- the Consolidated interim cash flow statement for the period then ended;
- the Consolidated interim statement of changes in shareholders' equity for the period then ended; and
- the explanatory notes to the unaudited interim financial information.

The interim financial information included in the unaudited interim results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial information, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial information and the review

Our responsibilities and those of the directors

The half-yearly report, including the interim financial information, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the unaudited interim results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial information in the unaudited interim results based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, 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.

What a review of interim financial information involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

Independent review report to KCOM Group PLC continued

Report on the interim financial information continued

What a review of interim financial information involves continued

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the unaudited interim results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial information.

PricewaterhouseCoopers LLP
Chartered Accountants
London
28 November 2017