KCOM

29 November 2016

KCOM GROUP PLC (KCOM.L) ANNOUNCES UNAUDITED INTERIM RESULTS TO 30 SEPTEMBER 2016

Highlights

- Further progress with our strategy:
  - Shift in Enterprise focus towards high value integration and cloud based solutions
  - Accelerated fibre deployment in Hull and East Yorkshire, with market leading take-up
  - Integration of the business behind a single brand, enabled by investment in systems and processes
- Banking facility extended giving 5 year period on existing terms
- Interim dividend of 2.00 pence (2015: 1.97 pence)
- Reconfirming dividend commitment of no less than 6.00 pence per annum for current and next financial year

	Unaudited Six months ended 30 Sept 2016 £m	Unaudited Six months ended 30 Sept 2015 £m	Movement on prior period %
Results before exceptional items			
Revenue	165.3	177.9	(7.1)
EBITDA	32.0	37.2	(14.0)
Operating profit	18.9	26.3	(28.1)
Profit before tax	17.7	24.6	(28.0)
Adjusted basic earnings per share (pence)* (Note 5)	2.78	3.82	(27.2)
Reported results			
Net cash (outflow)/inflow from operations	(5.0)	35.9	(113.9)
Net debt (Note 8)	45.7	103.0	(55.6)
Profit before tax	16.1	24.2	(33.5)
Basic earnings per share (pence) (Note 5)	2.52	3.76	(33.0)
Interim dividend per share (pence) (Note 6)	2.00	1.97	1.5

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

Commenting on the results, Chief Executive Bill Halbert says:

"Our transformation continues to progress well. At the beginning of the year, we came together under a single brand enabling us to simplify the way we work. We are investing more in our systems and changing the size and skills of our teams, in order to focus more tightly on our strategic growth areas of Enterprise and Hull and East Yorkshire.

The disposal of certain national network assets last year was a fundamental part of our journey. The proceeds received gave us the opportunity to increase investment in our focus areas and has enabled us to continue to restructure the business.

Within our Enterprise segment, there is an ongoing shift towards more complex high value customer solutions. We are becoming recognised as a trusted technology partner for organisations looking to exploit communications and IT services to achieve their business ambitions. We are in the process of implementing such solutions for Bupa, Association of Train Operating Companies (ATOC) and Shoosmiths, while strengthening also relationships with other key customers, such as HMRC and National Farmers Union Mutual (NFUM).

Within Hull and East Yorkshire, our accelerated fibre deployment continues to achieve market leading take-up rates and we remain on target to make ultrafast services available to two thirds of our customer base by December 2017. The Group's interim dividend will be 2.00p per share and we re-confirm our commitment to a minimum full year dividend of 6.00p per share for this and the next financial year."

Outlook

We remain confident in our ability to exploit the opportunities that exist in our chosen markets, under our new single brand. Investment plans will be focused on fibre deployment in Hull and East Yorkshire, transformation of our existing network technologies, and on systems, processes, skills and capabilities. We are creating a simplified business which can operate on a reduced cost base and generate sustainable value for shareholders.

As previously outlined, capital expenditure is likely to peak over this year and the subsequent year, as we continue the fibre deployment and other key near term investments. As we focus investment more tightly around Enterprise and our Hull and East Yorkshire market, we expect to see continued revenue decline in other legacy areas. This trend is expected to continue during the second half of the financial year.

The Board remains confident in the continued transformation of the business and the sustainable value creating opportunities it will unlock in the medium term.

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Review of the half year
The six months to 30 September 2016 is our first period operating as a single business under one KCOM brand. This supports our longer term business transformation whilst enabling us to simplify the way we work to achieve efficiencies and associated cost savings.

The proceeds from the sale of certain national network assets in January 2016 are being reinvested to support the accelerated deployment of fibre in Hull and East Yorkshire and the continued reshaping of the business, in support of our strategy.

Our results for the period show a decrease in revenue and EBITDA. This arises, as expected, from a shift in focus away from commodity business towards value driven solutions, coupled with the additional cost of our fibre network outsource.

The performance in our Hull and East Yorkshire market continues to benefit from strong fibre take-up. In the Enterprise market, where we are uniquely positioned, we continue to shift our focus towards significant integration and collaboration contracts with key customers.

In September, we completed the extension of our banking arrangements, securing a facility of £180 million for a further five years through to December 2021, on existing terms. This medium term certainty reduces the Group's risk and provides further opportunities for growth.

Segmental performance
The following analysis relates to the Group's reported segments in the period ended 30 September 2016 and all results are stated before exceptional items.

	30 Sept 2016 Revenue £m	30 Sept 2015 Revenue £m	**30 Sept 2016 Contribution £m**	30 Sept 2015 Contribution £m
Hull and East Yorkshire	**50.4**	52.2	**36.0**	35.5
Enterprise	**68.3**	75.4	**13.7**	15.2
SMB National	**48.5**	52.9	**11.6**	12.8
Total	**167.2**	180.5	**61.3**	63.5
Shared	**(1.9)**	(2.6)	**(29.3)**	(26.3)
			EBITDA £m	EBITDA £m
Total	**165.3**	177.9	**32.0**	37.2

Hull and East Yorkshire
Our Hull and East Yorkshire segment offers communication based services for consumers, small and medium businesses and public sector organisations within Hull and East Yorkshire.

During the period, our accelerated deployment of fibre has resulted in a further 26,000 premises being passed. We have passed 104,000 premises to date and expect to reach 150,000 premises passed by December 2017 (more than two thirds of our customer base). Fibre take up here remains strong with 9,000 further premises connected in the period, including 1,000 businesses, taking the total connected so far to 33,000 properties.

Despite a small overall decline in revenue within this segment, our underlying contribution percentage has increased in comparison to the prior year; this was enhanced by a one-off supplier credit received during the period.

Within the consumer channel, our fibre deployment has enabled us to access more customers and increase our Average Revenue Per User (ARPU) by 2%, resulting in market leading take-up rates in excess of 30 per cent of homes passed. Broadband connection volumes have grown in the period.

The business channel experienced a small reduction in revenue as a result of a decline in legacy voice services, alongside lower Public Sector expenditure on bandwidth following migration to a Public Services Network and consolidation of estate.

Wholesale revenues decreased slightly and, as anticipated, our non-core contact centre and publishing revenues have continued to decline.

Enterprise
Our Enterprise segment offers converged communication and IT solutions to our largest customers. This segment continues to benefit from increased investment, and represents the Group's best opportunity for growth, by exploiting our unique position in those converged services.

We continue to expand our relationship with our largest customer, HMRC, however given the scale of the revenue earned in the prior year from the early project phase of that contract, together with the anticipated decline in network based legacy activities has meant that we have seen, as signalled, a relative decline in overall revenues from the Enterprise segment. Other than this, revenue shows a small increase.

SMB National
Our SMB National segment offers communication services to medium sized business customers outside of Hull and East Yorkshire.

The SMB National market is no longer core to our strategy as it is increasingly difficult to differentiate our services in this highly commoditised market. As a result, SMB National has not benefitted from the increased investment we have made in our Enterprise and Hull and East Yorkshire segments.

Our results for the period reflect this, with a solid revenue and contribution performance, albeit behind the comparative period. We anticipate this trend continuing in the second half of the year.

Shared costs
Our shared segment provides technical and engineering support, alongside IT, Finance, Estates, Legal and HR services. This segment also includes PLC costs such as share scheme expenses and certain pension costs.

This segment includes higher network costs following the sale of some of our national network assets in the prior period. Offsetting this, our underlying costs have decreased as we have continued to simplify the way we work to achieve efficiencies.

Exceptional items
Our continued business transformation has resulted in the need to restructure our business in order to provide the right number of people with the right skills and bring together our activities under a single brand. As a result, and in line with our accounting policy, the Group incurred costs of £1.7 million during the period. We expect further restructuring costs in the second half of the year.

Refinancing, net debt and cash flow
In September, we agreed a new five year £180 million revolving credit facility, on the same terms as our existing arrangements.

Net debt at 30 September 2016 is £45.7 million (30 September 2015: £103.0 million), representing a net debt to EBITDA ratio of 0.66x (30 September 2015: 1.36x).

The £53.1 million increase in net debt compared to 31 March 2016 (net funds of £7.4 million) is explained by outflows relating to strategic capital investment (£27.1 million), dividends (£20.4 million) pensions (£4.7 million) and tax (£4.9 million) in addition to movements in working capital.

Our working capital outflow of £25.9 million includes an £18 million VAT payment to HMRC in relation to the disposal of certain network assets in the prior year. Whilst fluctuations in our working capital occur during the year, our days' sales outstanding was 39, which is broadly in line with the prior period (30 September 2015: 41 and 31 March 2016: 32).

Dividend
The Group's interim dividend is 2.00 pence per share (30 September 2015: 1.97 pence), which is consistent with the Board's previously stated commitment to pay a total dividend of no less than 6.00 pence per year for the years ending 31 March 2017 and 31 March 2018. The dividend will be paid on 1 February 2017 to shareholders registered on 30 December 2016. The ex-dividend date is 29 December 2016.

Pensions

The IAS 19 pension liability at 30 September 2016 is £44.1 million (30 September 2015: £16.1 million and 31 March 2016: £14.4 million). The increase from 31 March arises as a result of a lower discount rate used to calculate the schemes' liabilities, offset by a strong asset performance.

The agreed level of deficit repair payment (across both schemes) for the year ending 31 March 2017 is £6.7 million (31 March 2016: £2.0 million). In addition to this amount, 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.

Our triennial valuation (as at 31 March 2016) is in the process of being finalised.

Capital investment

The Group's capital investment during the period is consistent with previous guidance of full year capital expenditure of at least £40 million.

The disposal of certain national network assets in the prior year enabled increased capital investment to drive our business transformation.

Cash capital expenditure during the period was £27.1 million (30 September 2015: £17.4 million). Key strategic projects in the period include the deployment of fibre (£7.1 million), alongside targeted customer specific and funded investment (£6.2 million).

The Group's depreciation and amortisation charge for the period is £13.2 million (30 September 2015: £10.9 million), the increase resulting from the higher capital investment in recent years.

Tax

The Group's tax charge is £3.2 million (30 September 2015: £5.1 million). The current year effective tax rate is 20.1%, broadly in line with the prevailing rate of corporation tax.

Principal risk 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:

- maintaining revenue in our Enterprise segment while network based revenue declines – revenue from legacy activities may decline faster than the revenue from new services grows;
- substitute technologies entering the market – the development of substitute technologies without the need for a fixed line would present a competitive threat within the consumer part of our business;
- upgrading 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 and delivery – delivering exceptional service to our customers is one of our key strategic aims and therefore the risk of failing to do this is a key risk for us to mitigate; and
- 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.

The risks outlined above are disclosed in more detail on pages 25 and 26 of the Annual report and accounts to 31 March 2016 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

	Note	**Unaudited six months ended 30 Sept 2016 £'000**	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Revenue		**165,326**	177,890	349,222
Operating expenses		**(148,122)**	(152,050)	(257,438)
Operating profit		**17,204**	25,840	91,784
Analysed as:				
EBITDA before exceptional items	1	**32,041**	37,197	74,937
Exceptional credits	2	**-**	2,700	47,331
Exceptional charges	2	**(1,671)**	(3,129)	(6,445)
Depreciation of property, plant and equipment		**(7,149)**	(6,291)	(13,744)
Amortisation of intangible assets		**(6,017)**	(4,637)	(10,295)
Finance costs	3	**(1,149)**	(1,632)	(3,057)
Share of profit of associates		**12**	5	16
Profit before tax	1	**16,067**	24,213	88,743
Tax	4	**(3,234)**	(5,081)	(17,609)
Profit for the period attributable to owners of the parent		**12,833**	19,132	71,134
Earnings per share (pence)				
Basic	5	**2.52**	3.76	13.96
Diluted	5	**2.49**	3.73	13.82

Consolidated interim statement of comprehensive income

	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Profit for the period	**12,833**	19,132	71,134
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Remeasurements of retirement benefit obligations	**(33,887)**	13,659	12,130
Tax on items that will not be reclassified	**6,019**	(3,001)	(2,426)
Total items that will not be reclassified to profit or loss	**(27,868)**	10,658	9,704
Items that may be reclassified subsequently to profit or loss			
Cash flow hedge fair value movements	-	(442)	(442)
Tax on items that may be reclassified	-	88	(569)
Total items that may be reclassified subsequently to profit or loss	**-**	(354)	(1,011)
Total comprehensive (expense)/income for the period attributable to owners of the parent	**(15,035)**	29,436	79,827

Consolidated interim balance sheet

	Note	**Unaudited as at 30 Sept 2016 £'000**	Unaudited as at 30 Sept 2015 £'000	Audited as at 31 Mar 2016 £'000
Non-current assets				
Goodwill		**51,372**	51,372	51,372
Other intangible assets		**47,004**	39,974	44,637
Property, plant and equipment		**100,886**	90,606	93,592
Investments		**61**	38	49
Deferred tax assets		**12,295**	10,947	8,356
		211,618	192,937	198,006
Current assets				
Inventories		**5,053**	2,399	2,638
Trade and other receivables		**77,606**	92,450	65,431
Cash and cash equivalents	8	**16,660**	14,221	14,857
Derivative financial instruments		**-**	224	-
		99,319	109,294	82,926
Assets classified as held for sale		**-**	41,766	-
		99,319	151,060	82,926
Total assets		**310,937**	343,997	280,932
Current liabilities				
Trade and other payables		**(113,141)**	(123,672)	(126,235)
Current tax liabilities		**(2,419)**	(5,106)	(5,459)
Bank overdrafts	8	**(2,699)**	-	(1,645)
Derivative financial instruments		**(2)**	-	(11)
Finance leases		**(2,587)**	(3,021)	(3,271)
Provisions for other liabilities and charges		**(297)**	(784)	(738)
Non-current liabilities				
Borrowings	8	**(54,133)**	(108,687)	-
Retirement benefit obligations	7	**(44,076)**	(16,100)	(14,350)
Deferred tax liabilities		**(6,037)**	(4,334)	(6,875)
Finance leases		**(2,944)**	(5,482)	(3,680)
Provisions for other liabilities and changes		**(2,171)**	(963)	(2,401)
Total liabilities		**(230,506)**	(268,149)	(164,665)
Net assets		**80,431**	75,848	116,267
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		**(324,460)**	(329,043)	(288,624)
Total equity		**80,431**	75,848	116,267

Consolidated interim statement of changes in shareholders' equity

	Note	Share capital £'000	Share premium account £'000	Hedging and translation reserve £'000	Accumulated losses £'000	Total £'000
At 31 March 2015 (audited)		**51,660**	**353,231**	**442**	**(341,454)**	**63,879**
Profit for the period		-	-	-	19,132	19,132
Other comprehensive income		-	-	(442)	10,746	10,304
Total comprehensive income for the period ended 30 September 2015 (unaudited)		-	-	**(442)**	**29,878**	**29,436**
Deferred tax charge relating to share schemes		-	-	-	28	28
Current tax credit relating to share schemes		-	-	-	-	-
Deferred tax charge relating to asset-backed Partnership		-	-	-	269	269
Purchase of ordinary shares		-	-	-	(150)	(150)
Employee share schemes		-	-	-	880	880
Dividends	6	-	-	-	(18,494)	(18,494)
					(17,467)	(17,467)
At 30 September 2015 (unaudited)		**51,660**	**353,231**	**-**	**(329,043)**	**75,848**
Profit for the period		-	-	-	52,002	52,002
Other comprehensive income		-	-	-	(1,611)	(1,611)
Total comprehensive income for the period ended 31 March 2016 (audited)		**-**	**-**	**-**	**50,391**	**50,391**
Deferred tax charge relating to share schemes		-	-	-	97	97
Current tax credit relating to share schemes		-	-	-	90	90
Deferred tax credit relating to asset-backed Partnership		-	-	-	(269)	(269)
Purchase of ordinary shares		-	-	-	(300)	(300)
Employee share schemes		-	-	-	588	588
Dividends	6	-	-	-	(10,178)	(10,178)
					(9,972)	(9,972)
At 31 March 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 credit 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**

Consolidated interim cash flow statement

	Note	**Unaudited six months ended 30 Sept 2016 £'000**	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Cash flows from operating activities				
Operating profit		**17,204**	25,840	91,784
Adjustments for:				
- depreciation and amortisation		**13,166**	10,928	24,039
- (increase)/decrease in working capital		**(25,885)**	5,445	23,385
- restructuring cost and onerous lease payments		**(671)**	(1,870)	533
- pension deficit payments		**(4,697)**	(2,526)	(6,565)
- Share based payment charge		**703**	-	1,468
Tax paid		**(4,872)**	(1,900)	(7,206)
Loss/(profit) on sale of property, plant and equipment		**69**	-	(47,065)
Net cash generated from operations	8	**(4,983)**	35,917	80,373
Cash flows from investing activities				
Purchase of property, plant and equipment		**(16,211)**	(11,998)	(16,959)
Purchase of intangible assets		**(9,381)**	(4,252)	(11,467)
Proceeds on disposal of investments		**-**	-	90,000
Net cash used in investing activities		**(25,592)**	(16,250)	61,574
Cash flows from financing activities				
Dividends paid	6	**(20,354)**	(18,494)	(28,672)
Interest paid	8	**(534)**	(1,700)	(2,794)
Repayment of bank loans		**(5,000)**	(45,000)	(175,000)
Drawdown of bank loans		**60,000**	50,000	70,000
Capital element of finance lease repayments		**(1,479)**	(1,112)	(2,829)
Purchase of ordinary shares	8	**(1,309)**	(150)	(450)
Net cash used in financing activities		**31,324**	(16,456)	(139,745)
Increase/(decrease) in cash and cash equivalents		**749**	3,211	2,202
Cash and cash equivalents at the beginning of the period		**13,212**	11,010	11,010
Cash and cash equivalents at the end of the period	8	**13,961**	14,221	13,212

Notes to the unaudited interim financial information

1. Segmental analysis

As part of our continued business transformation, our activities came together under a single brand on 31 March 2016.

As a result of this change, the Group's previous brands were consolidated and our operating segments were updated. The operating segments continue to be based on customer type and geographic service location. The operating segments are as follows:

Hull and East Yorkshire - Our Hull and East Yorkshire segment offers communication based services for consumers, small and medium businesses and public sector organisations within Hull and East Yorkshire;

Enterprise - Our Enterprise segment offers communication and collaboration solutions to our largest customers;

SMB National - Our SMB National segment offers communication services to our medium sized business customers outside of Hull and East Yorkshire; and

Shared - Our shared segment provides technical and engineering support, alongside IT, Finance, Estates, Legal and HR services. This segment also includes PLC costs such as share scheme expenses and certain pension costs.

From 1 April 2016 KCOM has one business-wide EBITDA and segment EBITDA is no longer reported to the Board as a measure of segmental performance.

The profitability metric used to assess segmental performance is contribution, which represents gross margin plus certain costs, directly attributable to that segment.

	Revenue			Contribution		
	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	**Audited year ended 31 Mar 2016 £'000**	**Unaudited six months ended 30 Sept 2016 £'000**	Unaudited six months ended 30 Sept 2015 £'000	**Audited year ended 31 Mar 2016 £'000**
Before exceptional items						
Hull and East Yorkshire	**50,365**	52,231	104,515	**36,022**	35,468	71,220
Enterprise	**68,266**	75,426	147,666	**13,721**	15,208	29,770
SMB National	**48,639**	52,883	102,281	**11,581**	12,761	24,338
Total	**167,270**	180,540	354,462	**61,324**	63,437	125,328
Shared	**(1,944)**	(2,650)	(5,240)	**(29,283)**	(26,240)	(50,391)
					EBITDA	
Total before exceptional items	**165,326**	177,890	349,222	**32,041**	37,197	74,937
Exceptional items				**(1,671)**	(429)	40,886
Total after exceptional items	**165,326**	177,890	349,222	**30,370**	36,768	115,823

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 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited Year ended 31 Mar 2016 £'000
EBITDA post exceptional items	**30,370**	36,768	115,823
Depreciation	**(7,149)**	(6,291)	(13,744)
Amortisation	**(6,017)**	(4,637)	(10,295)
Finance costs	**(1,149)**	(1,632)	(3,057)
Share of profit of associates	**12**	5	16
Profit before tax	**16,067**	24,213	88,743

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

	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Revenue from external customers			
Hull and East Yorkshire	**48,095**	49,535	98,911
Enterprise	**68,254**	75,426	147,522
SMB National	**48,639**	52,883	102,281
Shared	**338**	46	508
Total	**165,326**	177,890	349,222
Inter-segment revenue			
Hull and East Yorkshire	**2,270**	2,696	5,604
Enterprise	**12**	-	144
SMB National	**-**	-	-
Shared	**(2,282)**	(2,696)	(5,748)
Total	**-**	-	-
	165,326	**177,890**	349,222

Notes to the unaudited interim financial information continued

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 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Profit on sale of national network	**-**	-	44,486
Ofcom settlement	**-**	2,700	2,845
Exceptional credits	**-**	2,700	47,331
Restructuring costs	**(1,671)**	(2,274)	(4,130)
Onerous lease costs	**-**	(855)	(2,315)
Exceptional charges	**(1,671)**	(3,129)	(6,445)
(Charged)/credited to profit before tax	**(1,671)**	(429)	40,886

Our continued business transformation has resulted in the need to restructure our business in order to provide the right number of people with the right skills and bring together our activities under a single brand. As a result, and in line with our accounting policy, the Group incurred costs of £1.7 million during the period.

In January 2016, the Group sold the infrastructure relating to its national telecommunications network for a consideration of £90.0 million. The profit on sale (£44.5 million) includes the net book value of assets disposed (£42.4 million) in addition to other associated costs (net £3.1 million).

Ofcom determined settlement relates to a settlement of claims relating to an industry-wide regulatory ruling; treated as exceptional in accordance with our accounting policy.

Onerous lease costs in prior periods arose as a result of rationalisation of the Group's property portfolio.

The tax credit on exceptional items is £0.3 million. The cash flow impact of exceptional items is £1.7 million.

Notes to the unaudited interim financial information continued

3. Finance costs

	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited Year ended 31 Mar 2016 £'000
Finance costs	**(929)**	(1,852)	(2,922)
Retirement benefit obligation	**(220)**	(600)	(954)
Fair value gain on financial instruments	**-**	820	819
Charged to profit before tax	**(1,149)**	(1,632)	(3,057)

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 20.1% (2015: 21.0%).

5. Earnings per share

	Unaudited six months ended 30 Sept 2016 No.	Unaudited six months ended 30 Sept 2015 No.	Audited year ended 31 Mar 2016 No.
For basic earnings per share	**510,141,695**	509,352,876	509,543,003
Share options in issue	**4,490,038**	3,384,917	5,225,401
For diluted earnings per share	**514,631,733**	512,737,793	514,768,404
Earnings	**£'000**	£'000	£'000
Profit attributable to equity holders of the company	**12,833**	19,132	71,134
Adjustments:			
Exceptional items	**1,671**	429	(40,886)
Tax on exceptional items	**(334)**	(86)	8,177
Adjusted profit attributable to equity holders of the company	**14,170**	19,475	38,425
Earnings per share	**Pence**	Pence	Pence
Basic	**2.52**	3.76	13.96
Diluted	**2.49**	3.73	13.82
Adjusted basic	**2.78**	3.82	7.54
Adjusted diluted	**2.75**	3.80	7.46

Notes to the unaudited interim financial information continued

6. Dividends

	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Final dividend for the year ended 31 March 2015 of 3.58 pence per share	**-**	18,494	18,494
Interim dividend for the year ended 31 March 2016 of 1.97 pence per share	**-**	-	10,178
Final dividend for the year ended 31 March 2016 of 3.94 pence per share	**20,354**	-	-
Total	**20,354**	18,494	28,672

The proposed interim dividend for the six months ended 30 September 2016 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.

7. Retirement benefit obligation

Reconciliation of funded status to balance sheet

	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Present value of defined benefit obligation	**(294,152)**	(222,600)	(227,538)
Fair value of plan assets	**250,076**	206,500	213,188
Deficit	**(44,076)**	(16,100)	(14,350)

Principal financial assumptions

	Unaudited six months ended 30 Sept 2016 %	Unaudited six months ended 30 Sept 2015 %	Audited year ended 31 Mar 2016 %
RPI Inflation	**3.00**	3.05	2.95
CPI Inflation	**2.00**	2.05	1.95
Rate of increase to pensions in payment	**2.00**	2.00	2.00
Discount rate for scheme liabilities	**2.15**	3.75	3.45

Notes to the unaudited interim financial information continued

8. Movement in net debt

	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited Year ended 31 Mar 2016 £'000
Opening net debt	**7,412**	(99,348)	(99,348)
Closing net debt	**(45,703)**	(102,969)	7,412
(Increase)/decrease in the period	**(53,115)**	(3,621)	106,760
Reconciliation of movement in the period			
Net cash flow from operations	**(4,983)**	35,917	80,373
Cash capital expenditure	**(27,071)**	(17,362)	(31,255)
Proceeds on sale of property, plant and equipment	**-**	-	90,000
Interest	**(534)**	(1,700)	(2,794)
Dividends	**(20,354)**	(18,494)	(28,672)
Purchase of ordinary shares	**(1,309)**	(150)	(450)
Movement in finance leases	**1,420**	(493)	(53)
Non cash movement in loan arrangement fees	**(271)**	-	-
Other	**(13)**	(1,339)	(389)
(Increase)/decrease in the period	**(53,115)**	(3,621)	106,760

Net debt comprises:

	Unaudited six months ended 30 Sept 2016 £'000	Unaudited six months ended 30 Sept 2015 £'000	Audited year ended 31 Mar 2016 £'000
Cash and cash equivalents (including bank overdrafts)	**13,961**	14,221	13,212
Borrowings (net of debt issue costs)	**(54,133)**	(108,687)	1,151
Finance leases	**(5,531)**	(8,503)	(6,951)
Total net debt	**(45,703)**	(102,969)	7,412

In September 2016 the Group re-negotiated its multi-currency revolving credit facility. The £180.0m facility provided by a group of five core relationship banks matures in December 2021. The Group considers that this facility will provide sufficient funding to support the Group's growth. In addition, short-term flexibility of funding is available under the £10.0 million overdraft facility provided by the Group's clearing banks.

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 2 to 3 and in the Strategic report in the Group's 2016 annual report and accounts.

This condensed consolidated interim financial information was approved for issue on 29 November 2016.

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 2016 were approved by the Board of directors on 8 June 2016 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 20.

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 2016 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 2016, 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 statements.

10. Accounting policies

The accounting policies adopted are consistent with those published in the Group's 2016 annual report and accounts, 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.

Assets classified as held for sale

Assets are classified as assets held for sale when their carrying amount is to be recovered through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell. Once classified as held for sale, intangibles assets and property, plant and equipment are no longer amortised or depreciated.

11. Significant judgements and estimates

The preparation of interim financial statements 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 estimates.

In preparing these condensed consolidated interim financial statements, 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 2016 annual report and accounts, with the exception of changes in estimates that are required in determining the provision for income taxes (see Note 10).

12. 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 statements 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 2016. 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 2016 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.

12. Financial risk management and financial instruments continued

Fair values

The fair value of bank borrowings is £49.8 million (March 2016: £Nil) compared to a book value of £54.1 million (March 2016: £Nil). The fair value of cash flows has been estimated using a rate based on the weighted average borrowing rate of 1.57%.

13. Related party transactions

There are no material related party transactions.

14. Subsequent events

In October, we received a provisional Notification from Ofcom. This stated that Ofcom believes KCOM may have failed to comply fully with a required "General Condition" between 2009 and 2015. We are carrying out a review, with the help of independent experts and will respond to Ofcom shortly, following which Ofcom will make its determination. There is a risk that the final outcome may result in a financial penalty, which we are not currently in a position to quantify.

15. Statement of directors' responsibilities

The directors confirm that these condensed interim financial statements have been prepared in accordance with IAS 34 as adopted by the European Union, and 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 2016 annual report and accounts.

The directors of KCOM Group PLC are listed in the KCOM Group Annual Report for 31 March 2016. Except for the change listed below.

Paul Simpson (resigned 30 September 2016)
Jane Aikman (appointed 17 October 2016)

Signed by Order of the Board on 29 November 2016 by:

Independent review report to KCOM Group PLC

Report on the condensed consolidated interim financial statements

Our conclusion

We have reviewed KCOM Group PLC's condensed consolidated interim financial statements (the "interim financial statements") in the unaudited interim results of KCOM Group PLC for the 6 month period ended 30 September 2016. 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 2016;
- the consolidated interim income statement and 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 condensed consolidated interim financial statements.

The interim financial statements 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 9 to the interim financial statements, 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 statements and the review

Our responsibilities and those of the directors

The unaudited interim results, including the interim financial statements, 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 statements 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 statements 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.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) 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 statements.

PricewaterhouseCoopers LLP
Chartered Accountants
Leeds
29 November 2016