Half year results

Six months ended 30 September 2019

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Introduction

“Good visibility of future revenues, strong and improving margins and continued excellent cash conversion.”

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HY20 financial review

Dean Barber
Chief Financial Officer

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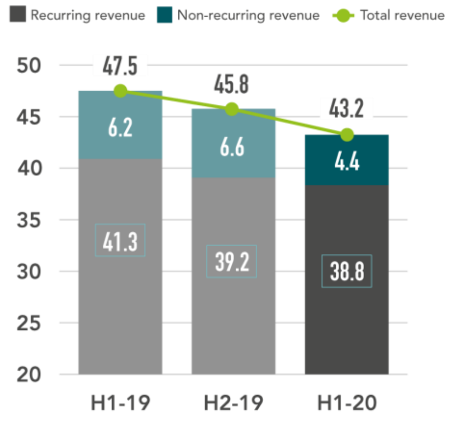
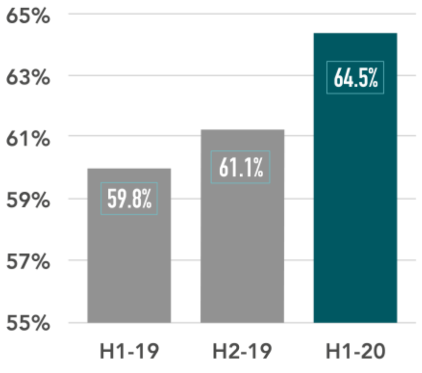
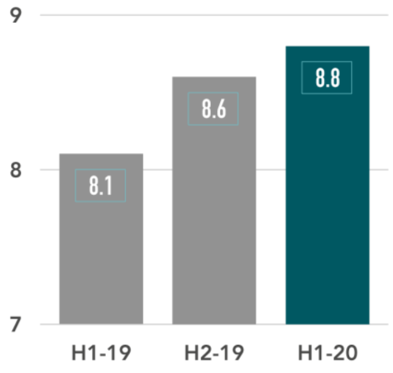
HY20 financial highlights

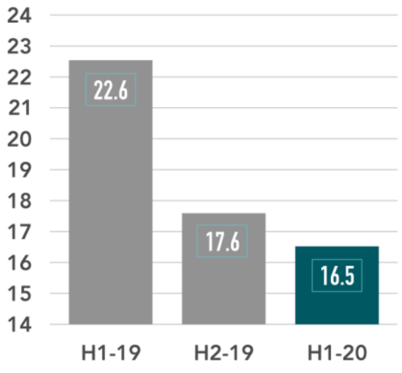
Results in line with Board’s expectations

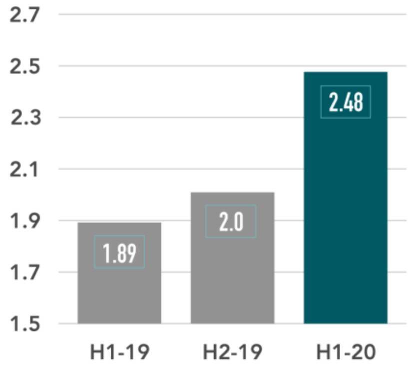
REVENUE	GROSS MARGIN	ADJUSTED EBITDA*	NET DEBT	ADJUSTED EPS*
£43.2m (-9%)	64.5% (+4.7%pts)	£8.8m (+8%)	£16.5m (-27%)	2.48p (+31%)
Recurring revenue of £38.8m, down 1% sequentially, and represents 90% of total revenue (H1-19: 87%)	Gross profit £27.8m (H1-19: £28.4m)	Adjusted EBITDA margin of 20.3% (H1-19: 17.1%)	Reduction of £1.1m in the period, after dividends of £1.5m and share buy-back of £0.3m	Profit growth drives adjusted EPS increase of 31%











* Adjusted EBITDA excludes exceptional items and share-based payments. Adjusted EPS excludes amortisation on acquired intangibles, exceptional items and share-based payments.

Financial highlights are set out a pre-IFRS 16 basis. The impact of IFRS 16 is set out in the appendices.

Group income statement (pre-IFRS 16)

Good revenue visibility, improved margins and profit growth

	H1-19 £m	H2-19 £m	H1-20 £m	H1-20 vs H1-19 %
Revenue	47.5	45.8	**43.2**	-9%
Cost of Sales	(19.1)	(17.8)	**(15.4)**	-20%
Gross margin	*59.8%*	*61.1%*	***64.5%***	*+4.7%pts*
Gross Profit	28.4	28.0	**27.8**	-2%
Operating Costs	(20.3)	(19.4)	**(19.0)**	-6%
Adjusted EBITDA	8.1	8.6	**8.8**	+8%
EBITDA Margin	*17.1%*	*18.8%*	***20.3%***	*+3.2%pts*
Depreciation & Amortisation	(7.2)	(7.5)	**(6.9)**	-4%
Exceptional items	(0.2)	(1.7)	**(0.2)**	-30%
Share based payments	(0.2)	(0.2)	**(0.3)**	+5%
Interest	(0.6)	(0.5)	**(0.4)**	-28%
Result before taxation	(0.1)	(1.3)	**1.0**	+933%
Taxation	(0.5)	(0.1)	**(0.4)**	-10%
Result after tax	(0.6)	(1.4)	**0.6**	+206%
Earnings per share				
Adjusted EPS	1.89p	2.00p	**2.48p**	+31%
Reported EPS	(0.38)p	(0.94)p	**0.41p**	+208%

- Total revenue declined by 9% to £43.2m. Recurring revenue mix improved to 90% of total revenue (H1-19: 87%)
- Recurring revenues improved in Q2-20 driven by new logo wins and effective cross-selling
- Gross profit decreased by 2% to £27.8m. Gross margin improved by 4.7%pts to 64.5% due to management of third-party costs and decrease in lower margin product revenues
- Operating costs have reduced by £1.2m with UK staff costs down £0.8m and consultancy bid costs lower by £0.5m
- Exceptional items of £169k re FCA costs / staff redundancy costs. H2-19 exceptionals included £0.8m staff restructuring and £0.6m Theale office onerous lease provision
- Interest costs reduced by 28% with a £1.1m reduction in net debt in the period and £7.5m of unutilised bank facility cancelled

Cash flow (pre-IFRS 16)

Positive cash flow performance again delivered

	H1-19 £m	H2-19 £m	H1-20 £m
Adjusted EBITDA	8.1	8.6	**8.8**
Working capital movements	1.1	3.5	**(0.1)**
Adjusted cash generated from operations	9.2	12.1	**8.7**
Capex – cash purchases	(2.9)	(2.3)	**(2.2)**
Capex – finance leases	(0.2)	(2.3)	**(2.5)**
Capex – proceeds	-	1.8	**-**
Net capex	(3.1)	(2.8)	**(4.7)**
Corporation tax	-	(1.8)	**(0.3)**
Interest paid	(0.5)	(0.5)	**(0.4)**
Other	(0.1)	(0.2)	**-**
Normalised net debt movement	5.5	6.8	**3.2**
Cash cost of exceptionals	(0.4)	(1.2)	**(0.4)**
Share buy-back	-	-	**(0.3)**
Dividends	-	(0.6)	**(1.5)**
Decrease in net debt	5.1	5.0	**1.1**
Closing net debt	(22.6)	(17.6)	**(16.5)**

- Adjusted cash generated from operations (before exceptionals) 6% lower at £8.7m with operating cash conversion of 99%
- Small working capital outflow of £0.1m, against strong comparative periods
- Capex includes:
  - £1.1m national network upgrade (100gb)
  - £1.5m IaaS platform investment
  - £0.9m spent on internal ERP solution
- £0.3m spent on share buyback programme
- Dividends paid of £1.5m in the period. Interim dividend for H1-20 of 0.83p (H1-19: 0.40p) to be paid Jan-2020
- Net debt of £16.5m (£1.1m reduction from year-end and £6.1m reduction from H1-19)

Balance sheet (pre-IFRS 16)

Solid balance sheet maintained

	H1-19 £m	H2-19 £m	H1-20 £m
Goodwill and other intangibles	79.4	75.8	**72.3**
Property, plant and equipment	19.2	18.1	**19.4**
Current assets	22.9	22.5	**19.9**
Deferred income	(7.8)	(9.1)	**(8.1)**
Other current liabilities	(12.6)	(13.2)	**(11.6)**
Provisions	(0.5)	(1.0)	**(1.0)**
Deferred tax	(0.5)	0.1	**0.3**
Net debt	(22.6)	(17.6)	**(16.5)**
Net assets	77.5	75.6	**74.7**

- Acceleration of property, plant and equipment spend in H1-20
- Debtor days have reduced to 40 days (H1-19: 44 days), with debt > 180 days of £0.1m (H1-19 £0.4m)
- Along with high levels of recurring revenue, the deferred income balance provides good revenue visibility
- Provisions relate to vacant property / dilapidations

Net debt analysis

	H1-20 £m
Cash	2.2
RCF	(12.5)
Term loan / fees	(0.2)
Finance lease	(6.0)
Net debt (pre-IFRS 16)	**(16.5)**
IFRS 16 lease liabilities	(23.5)
Net debt	**(40.0)**

- Net debt of £16.5m with current facilities in place until 30 November 2020. Dialogue already underway with lenders
- RCF facility of £17.5m and overdraft facility of £2.0m at 30 Sept 2019 (£7.0m undrawn)

HY20 operational review

Peter Brotherton
Chief Executive Officer

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Products, platforms and networks

Modern, resilient, optimised and scalable

Products

- Product management and development teams have been restructured
- Restructure has yielded immediate results with managed firewall and SD WAN launched in Q3 FY20; further enhancement to our collaboration and security portfolios to be launched in Q4 FY

Platforms and networks

- Core network upgraded to enable 10Gb connections and work in progress to upgrade the core to 100Gb
- Final phase of new IaaS platform underway
- Significant investment made in Shoreditch data centre
- The above investments, coupled with the significant investments made in FY19, will result in lower levels of capex in the future

Optimisation

- Network ring decommissioned in the period has realised £0.5m annualised savings
- Currently undertaking a strategic review of our data centre and network portfolio; annualised savings of £1.8m actioned to date with at least a further £1.0m anticipated

Revenue & Margin

Recurring revenue stabilised, margins continue to improve

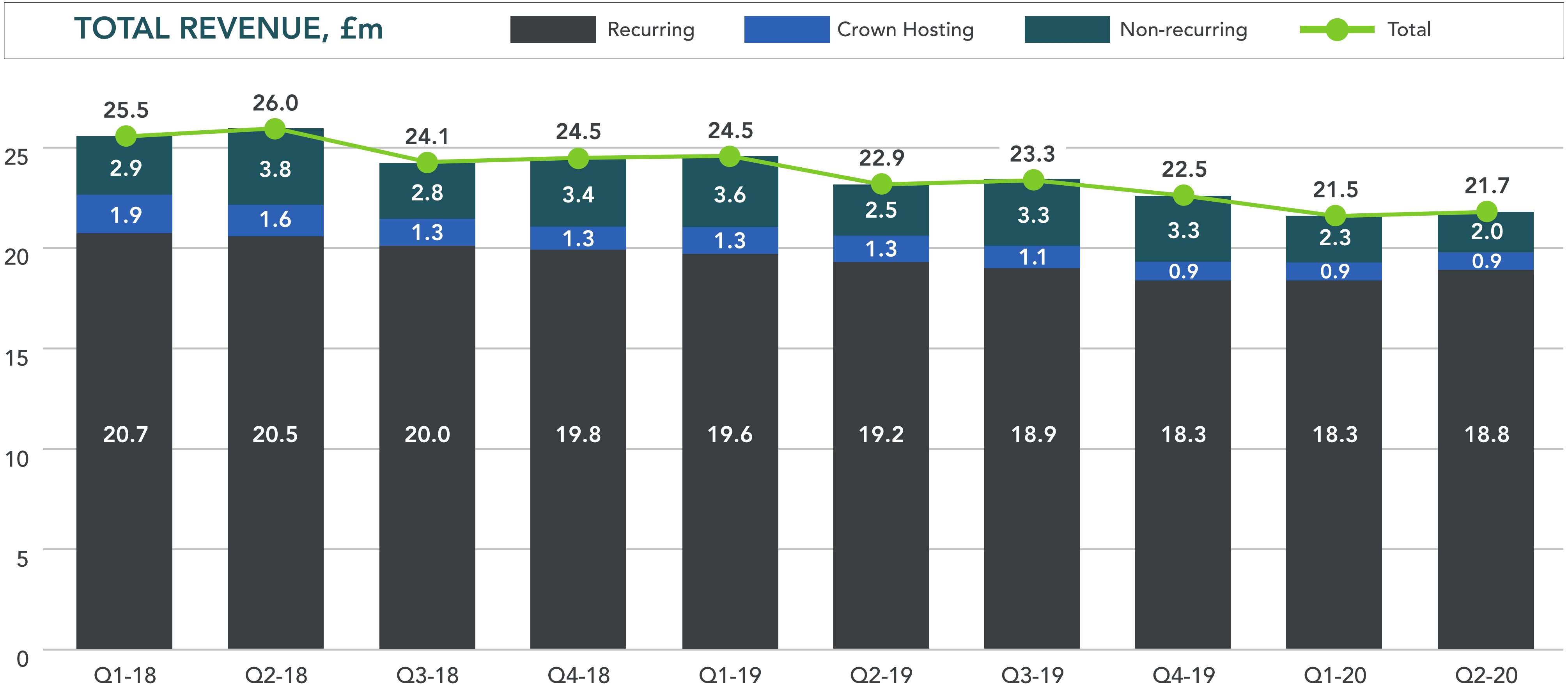
Revenue

- H1-20 recurring revenue down marginally on H2-19 (-1%) with Q1 flat on Q4 and Q2 up on Q1
- Public sector hosting revenues down by £0.8m on H1-19 and £0.2m on H2-19. Public sector hosting revenues expected to decline by £1.1m in H2-20
- Product sales are down reflecting delayed purchasing decisions due to the current economic uncertainty and the industry trend of businesses moving their IT off premise
- The roll out of the HSCN contract wins has been much slower than anticipated. The HY results reflect just £0.2m of revenue. The roll outs are expected to be substantially complete by the end of the financial year

Margin

- Full effect of the cost measures undertaken in November 2018 have fed through into the first half numbers with a resulting increase in both gross margin and EBITDA margin
- Further significant cost efficiencies from the network and data centre review have been identified. Expected annualised savings of at least £2.8m realised in FY21 onwards, with £0.4m of benefit in H2-20

Quarterly Revenue trend



- FY17 Crown Hosting revenues were £8.2m
- Further cancellations confirmed reduce Crown Hosting revenues to £0.5m in Q3-20 and £0.2m in Q4-20 (FY20 total of £2.5m)

Sales & Marketing

YoY growth in sales order intake and pipeline, revised value proposition, long-term contracts

Public Sector

- Strong progress made on YHPSN in period:
  - 70 organisations on framework
  - 53 signed call-off contracts
  - 44 of these have placed orders
  - A further 22 additional HSCN regional orders
- 66 new logos signed in the period provide excellent cross-sell opportunity
- Present on a number of other key frameworks including Network Services 2 and G-Cloud 11

Private Sector

- Strong performance on retaining and extending existing customer contracts
- Strong performance on up-sell to our existing base
- Improved renewal margins
- Longer term contracts secured
- New logo business secured and additional opportunities progressing through sales process

Marketing

- New value proposition and messaging focused on customer enablement and customer advocacy
- Five N3 to HSCN overlay campaigns launched
- SD-WAN launched – four proof of concept prospects being developed
- AI Voice and Managed SIEM launches planned Q4 FY20
- New website launched

Summary & outlook

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Summary and outlook

Recurring revenues growing, margins improving, continued excellent cash conversion

Summary

- Recurring revenue now stabilised
- Sales order intake significantly improved YoY (30% total contract value)
- Improvement in operating margin as a result of cost reduction programme in H2-19 and the data centre and network rationalisation project
- Significant investments in networks and platforms
- New products launched
- Excellent cash conversion enables further reduction of net debt and a doubling of interim dividend (0.83p per share)

Outlook

- Modest growth in revenue forecast for H2
- Roll out of HSCN and YHPSN contracts substantially completed by year end
- Continued excellent cash conversion enabling further reduction in net debt in addition to increased dividend payments and share buybacks
- Further annualised cost efficiencies of at least £2.8m anticipated following the completion of the network and data centre optimisation programme
- FY20 outlook in line with Board expectations

Financial guidance and trends

Factors affecting future financial performance

Data centre & network review

Operating expenditure savings of £2.8m anticipated to be realised from FY21 onwards

Exceptional cost of approx. £1.8m in H2-20

Capital expenditure

Lower spend in H2, following accelerated spend of £4.8m in the first half. FY20 spend expected to be circa £6m

FY21 spend to be lower than FY20

Tax rate

Expected to be close to UK statutory rate

Working capital

H2 position expected to be broadly neutral, following H1 outflow of £0.1m

Dividends

Dividend policy of 50% of adjusted earnings (pre-exceptionals and acquired intangible amortisation)

Interim dividend of 0.83p per share (£1.2m) to be paid in January 2020, 1/3 of anticipated total dividend for the year

IFRS 16

H2 depreciation and interest charges to be in line with those seen in the first half

FY20 & FY21 EBITDA benefit of £3.1m

Share-based payments

H2 spend expected to be in line with that seen in the first half

Share buyback

£0.3m spent in the first half with total spend of up to £2m (circa 1.7% of issued share capital) approved by the Board to date

Shareholder approval in place for purchase of up to 5% of issued share capital (circa £6m)

Appendices

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Investment case

Good visibility of future revenues, strong and improving margins, proven cash conversion, low and reducing levels of net debt

- Recurring revenue now stabilised
- High visibility of future revenue: 90% recurring revenue secured on long-term contracts (average contact length of 33 months for contracts signed in H1-20)
- EBITDA margin of >20%
- Optimisation of network and data centres will result in significant further cost efficiencies
- Lower levels of capex anticipated in the future following significant investment in FY19 and H1-20
- Track record of strong cash flows enables significant dividend payment and reduction of net debt
- Significantly improved sales pipeline, new contract wins in public sector provide excellent cross-sell opportunities

HY-20 impact of IFRS 16

Income statement

	Pre-IFRS 16 £m	IFRS 16 adj. £m	Post-IFRS 16 £m
Revenue	43.2	-	**43.2**
Cost of Sales	(15.4)	-	**(15.3)**
Gross Profit	27.8	-	**27.8**
Operating Costs	(19.0)	1.6	**(17.5)**
Adjusted EBITDA	8.8	1.6	**10.3**
Depreciation & Amortisation	(6.9)	(1.1)	**(8.0)**
Exceptional items	(0.2)	-	**(0.2)**
Share based payments	(0.3)	-	**(0.3)**
Interest	(0.4)	(0.6)	**(1.0)**
Result before taxation	1.0	(0.1)	**0.9**
Taxation	(0.4)	-	**(0.4)**
Result after tax	0.6	(0.1)	**0.5**
Earnings per share			
Adjusted basic EPS	2.48p	(0.07)p	**2.41p**
Reported basic EPS	0.41p	(0.07)p	**0.34p**

Balance sheet

	Pre-IFRS 16 £m	IFRS 16 adj. £m	Post-IFRS 16 £m
Goodwill and other intangibles	72.3	-	**72.3**
Property, plant and equipment	19.4	-	**19.4**
Right-of-use asset	-	21.1	**21.1**
Current assets	19.9	(0.1)	**19.8**
Deferred income	(8.1)	-	**(8.1)**
Other current liabilities	(11.6)	-	**(11.6)**
Provisions	(1.0)	-	**(1.0)**
Deferred tax	0.3	-	**0.3**
Net debt	(16.5)	(23.5)	**(40.0)**
Net assets	74.7	(2.5)	**72.2**

- The Group has recognised £1.1m of depreciation charges and £0.6m of interest costs in respect of IFRS 16 finance leases that would have previously been recognised as a £1.6m operating lease expense
- At 30 September a £21.1m right of use asset has been recognised together with current lease liabilities of £2.0m and non-current lease liabilities of £21.5m

FY-20 & FY-21 impact of IFRS 16

P&L impact, £'000's

	H1-20	H2-20	FY20	H1-21	H2-21	FY21
EBITDA	1,571	1,571	3,142	1,568	1,534	3,102
Depreciation	(1,103)	(1,103)	(2,206)	(1,103)	(1,097)	(2,200)
Finance costs	(597)	(571)	(1,168)	(547)	(530)	(1,076)
Profit before tax	(129)	(103)	(232)	(82)	(93)	(175)
Tax	25	20	45	16	18	33
Profit after tax	**(104)**	**(84)**	**(188)**	**(66)**	**(75)**	**(141)**
Basic EPS	**(0.07)p**	**(0.06)p**	**(0.13)p**	**(0.04)p**	**(0.05)p**	**(0.09)p**

Closing balance sheet, £'000's

	H1-20	FY-20	H1-21	FY-21
ROU asset	21,079	19,976	18,873	17,776
Lease liabilities	(23,505)	(22,505)	(21,484)	(20,479)

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