

Gamma Communications plc
Unaudited Results for six months ended 30 June 2017

Strong results for first half

Gamma Communications plc (“Gamma”), a leading, technology based provider of communications services to the UK business market, is pleased to announce its unaudited results for the six months ended 30 June 2017.

Financial highlights

| Six months ended 30 June | | | |
|--|--------------|--------------|-------------------|
| | 2017 | 2016 | Change (%) |
| Revenue | £115.0m | £104.7m | +9.8% |
| Gross profit | £54.1m | £47.7m | +13.4% |
| <i>Gross margin</i> | <i>47.0%</i> | <i>45.6%</i> | |
| EBITDA | £18.5m | £14.9m | +24.2% |
| Adjusted EBITDA | £19.7m | £16.3m | +20.9% |
| PBT | £12.5m | £10.6m | +17.9% |
| Adjusted PBT | £13.7m | £12.0m | +14.2% |
| Fully Diluted EPS | 11.8p | 9.1p | +29.7% |
| Adjusted EPS (Fully Diluted) | 11.6p | 10.1p | +14.9% |
| Dividend per share | 2.8p | 2.5p | +12.0% |
| Adj net operating cash inflow (i.e. before tax) | £15.3m | £13.8m | +10.9% |
| <i>Net operating cash inflow before tax / Adj EBITDA</i> | <i>77.7%</i> | <i>84.7%</i> | |

All adjusted measures set out above and throughout this document which are described as “adjusted” are reconciled within the statement of comprehensive income or in the Financial Review section or segment note and are applied consistently. Where reference is made to adjusted EPS this is stated on a fully diluted basis. Definitions of adjusted performance measures are included in Note 2.

Operational highlights

- The Cloud PBX and SIP Trunking connections continue to grow ahead of the market:
 - The number of installed SIP Trunks increased from 511,000 at 31 December 2016 to 605,000 at 30 June 2017 (+18.4%).
 - The number of Cloud PBX users increased from 230,000 to 276,000 (+20.0%).
- Growth in data products was strong:
 - Business broadband connections increased from 54,000 to 65,000 (+20.4%).
 - Ethernet connections rose from 3,520 to 4,322 (+22.8%).
- As the new Gamma mobile network came into operation data traffic on it grew from 20.5 Tbytes in H2 2016 to 35.0 Tbytes in H1 2017 (+70.7%).
- Strong growth in the indirect business:
 - Gross profit from indirect business increased from £37.6m to £41.7m (+10.9%).
 - The number of Channel Partners grew from 970 to 1,023 (+5.5%).
- Significant wins in the direct business drive growth:
 - Gross profit up from £10.1m to £12.4m (+22.8%).
 - New customers include itsu, Savills plc and Care UK.
 - Good progress in the public sector, key wins include Macmillan Cancer Support, Manchester University Hospitals NHS Foundation Trust whilst Your Housing Group added data, Cloud PBX and contact services to the previous SIP and mobile contract.

- New product development has continued with:
 - Launch of Cloud Compute and Backup, providing packaged server applications for small to medium sized businesses.
 - Extension of the Horizon Cloud PBX service to provide increased integration with specific vertical CRM applications in areas such as recruitment and primary healthcare.
 - We remain on target for the launch of our fixed/mobile converged product later this year.

Bob Falconer, Chief Executive Officer, commented

"I am pleased with the performance of the business in the first half. We have continued to successfully grow revenue and margin across our core products and markets, with a particularly strong performance in enterprise and a growing capability in the public sector, leading to contracts with organisations such as itsu, Savills plc and Macmillan Cancer Support. Our SIP and Cloud PBX services continue to perform well and we are now seeing accelerated growth in data services following the investments we have made in our network; important in a market where customers are increasingly looking to buy all their communications services from one supplier. Other initiatives, such as Gamma Accelerate, a marketing and lead generation platform, are helping the channel, which is our primary route to market, to increase sales. Significant resources also continue to be placed on enhancing our current products whilst developing exciting new capabilities, in particular maximising the opportunities from our growing Full MVNO mobile service."

Enquiries:

Gamma Communications plc

Tel: +44 (0)333 006 5972

Bob Falconer, Chief Executive Officer
Andrew Belshaw, Chief Financial Officer

Investec Bank plc (NOMAD & Broker)

Tel: +44 (0)207 597 5970

Andrew Pinder / Sebastian Lawrence
Patrick Robb / Matt Lewis

Tulchan Communications LLP (PR Adviser)

Tel: +44 (0)207 353 4200

James Macey White / Matt Low

Notes to Editors

Gamma is a rapidly growing, technology based, provider of communications services to the UK business market. Gamma's services, such as Cloud PBX, Inbound Call Control Services and SIP Trunking, are designed to meet the increasingly complex voice, data and mobility requirements of businesses, through the exploitation of its know-how and own intellectual property.

Gamma also provides business-grade mobile and data services and, as a consequence of its history, has a substantial voice service capability. These services enable Gamma to provide a comprehensive range of communications services.

Gamma has enjoyed strong organic revenue and EBITDA growth driven by a high percentage of repeat revenues. The business had 821 employees at 30 June 2017. It operates across six main locations – headquartered in Newbury - with offices in London, Manchester, Glasgow, Portsmouth and Budapest.

Chairman's statement

Introduction

I am pleased to present the unaudited results for the half year ended 30 June 2017.

Overview of Results

Group revenue for the half year ended 30 June 2017 increased by £10.3m to £115.0m (H1 2016: £104.7m) an increase of 9.8% on the prior year and it is particularly pleasing that all of this growth is organic. Of this increase, £5.1m came from the indirect channel where revenue increased to £88.1m (H1 2016: £83.0m) while £5.2m came from the direct business which saw revenue increase to £26.9m (H1 2016: £21.7m). Gross profit for the six months to 30 June 2017 rose to £54.1m, an increase of 13.4% compared to the £47.7m achieved in the same period of 2016, whilst the gross margin increased to 47.0% (H1 2016: 45.6%) due to improved product mix. Adjusted EBITDA for the group increased by 20.9% to £19.7m (H1 2016: £16.3m).

Adjusted fully diluted earnings per share for the half year increased by 14.9% to 11.6p (H1 2016: 10.1p).

The adjusted net operating cash inflow (pre-tax) for the first half was £15.3m compared to £13.8m in H1 2016. This represents a cash to adjusted EBITDA conversion ratio in respect of 2017 of 77.7% compared to 84.7% for H1 2016; the conversion ratio is lower as Gamma has taken the opportunity to prepay some suppliers in advance of normal payment terms in return for improved commercial terms. Consequently, the closing cash balance for the half year was £28.7m compared to £28.2m at the end of December 2016.

Dividend

Gamma remains committed to a progressive dividend policy. The Board is therefore pleased to declare an interim dividend, in respect of the six months ended 30 June 2017, of 2.8 pence per share (2016: 2.5 pence) an increase of 12% which will be payable on Thursday 19 October 2017 to shareholders on the register on Friday 22 September 2017.

Business Development

It was pleasing to see strong growth in Gamma's SIP Trunking, Cloud PBX and data services, with margins remaining consistent with the prior period. Whilst Gamma has competitors across its product range, it has no similar sized peers in its sector offering such a full suite of products. This differentiated market position presents Gamma with opportunity for continued expansion as end users seek to source their IT and communications from a single supplier.

In the channel the Group continues to add new partners, with the number of partners increasing from 970 to 1,023. While Gamma will continue to look to take on new partners, there is an increasing focus toward encouraging our existing channel partners to sell more Gamma products (thereby increasing market share for both parties). One of our initiatives in this area is the launch of our partner marketing platform 'Accelerate'.

The direct business continues to complement the indirect channel with significant new contracts, including Macmillan Cancer Support, Care UK and Savills Group plc. In the Public Sector, prior investment in this market is delivering success, with several new contracts in both education and health with wins such as the Central Manchester University Hospitals NHS Foundation Trust.

Meanwhile continued network investment and strategic partnerships with other carriers is accelerating data growth and our Manchester venture "The Loop" has been selected by euNetworks to provide them with a significant extension to their own network.

We remain on target for the launch of our fixed/mobile converged product 'Connect' later this year. With the migration from the previous Vodafone Thin MVNO now complete, Gamma's own (Full MVNO) mobile service is starting to grow. Connect is a good example of the opportunities this presents for Gamma to create differentiated services in the market.

Board and Employees

In June, Richard Bligh, Director of Business Development, informed the Board of his intention to retire from full time executive roles and subsequently stepped down from the Board on 30 June 2017, but will remain an employee of Gamma until the end of September 2017. Thereafter, the Company will continue to benefit from Richard's significant company knowledge and industry expertise on a part-time consultancy basis. On behalf of everyone at Gamma, I would like to thank him for his loyal service over the past fourteen years.

As of the 30 June 2017, Gamma had 821 employees, an increase of 68 from 31 December 2016. This growth is driven by the general expansion of the business and the continued investment in new service development. Meanwhile operational gearing efficiencies have helped adjusted EBITDA margin grow from 15.6% of revenue in the first half of 2016 to 17.1% of revenue in the first half of 2017.

The company introduced a further three year sharesave scheme, following on from that introduced successfully in 2015. Once again it was particularly pleasing to see the exceptionally high take up with 231 staff choosing to participate.

The Board recognise the high levels of support and commitment from its staff and would like to express its thanks for their dedication, hard work and enthusiasm.

Outlook

The Board looks forward enthusiastically to the remainder of 2017 and beyond. Gamma has a healthy pipeline of both prospective customers and products. The channel is moving towards offering a full communications service to its customers. In this endeavour the channel needs good support and this broadens the market and creates the opportunity for Gamma to play a wider role. While Gamma remains a channel focused business, the direct arm is becoming a significant player in its own right, with a strong reputation in the market and we expect to see it continue to grow healthily.

Overall, the Board believe that Gamma has the products, financial resources and technical capabilities to continue to achieve its objectives.

Richard Last
Chairman

Chief Executive Review

Introduction

We are very pleased with the progress the business has made in the six months to 30 June 2017. The strategic products of SIP Trunking and Cloud PBX have continued their growth adding 94,000 SIP channels and 46,000 Cloud PBX seats respectively. Investments in data infrastructure are showing clear dividends and mobile has returned to growth following the migration from the Thin MVNO from Vodafone to Gamma's Full MVNO.

Both Indirect and Direct Channels have shown excellent growth, with the direct channel benefitting particularly as the more complex projects are completed and delivered to our larger enterprise and public sector customers.

Organisation

In January, we restructured the organisation both to focus all our direct sales under one MD, David Macfarlane, and to give increased product focus on both data and mobile through two external appointments, thereby strengthening the senior team. As part of that process, we significantly increased the sales and support resources on the SI (Systems Integrator) and BPO (Business Process Outsourcing) routes to market in recognition that these organisations respond to complex bids and need a partner fully engaged and resourced to support them in that process.

Products & Marketing

Gamma's core strategic products of SIP and Cloud PBX (the latter under the Horizon brand) continue to grow strongly in an increasingly competitive market. We continue to invest in developing our products and over the period we have:

- Increased the appeal of the product in specific vertical markets by adding to the number of CRM (Customer Relationship Management) systems interworking with Horizon (our Cloud PBX service): for example Bullhorn is the market leading CRM system for small / medium sized recruitment agencies, and the integration with Horizon will embed the calling features of Horizon, so that they can be utilised directly from the application.
- Added a "Cloud Compute" product to our portfolio, offering SMEs a packaged product of computer processing and backup services in partnership with Amazon Web Services.

We look forward to Q4 this year when we are scheduled to bring to market a number of exciting enhancements including:

- Connect – Gamma's convergence service that combines our Cloud PBX and Mobile products. This service will provide on a customer's mobile the features that are normally on a fixed voice service.
- Call Recording and PCI Compliance services to add value to the Cloud PBX, SIP Trunking and Mobile products. These enhancements will support businesses required to meet the increasingly stringent regulatory compliance requirements in both financial trading and credit card transactions.

We are also pleased with the return to growth of our mobile service following the anticipated reduction in volumes following the transition from the Vodafone Thin MVNO to Gamma's own Full MVNO platform. As the new Gamma mobile network came into operation data traffic on it grew from 20.5Tbytes in H2 2016 to 35Tbytes in H1 2017. These are still modest volumes but we believe mobile is a critical service over which it is important to have a degree of control to be able to build differentiated services, such as Connect, for the business market. There remains a considerable opportunity in this area, and the business continues to invest in this capability.

Recent investments in Gamma's broadband and Ethernet data products have allowed us to increase our price competitiveness by reducing our cost to serve. As part of that, the second phase of our build out programme to Openreach exchanges went live at the end of March and the network also now has access (under a commercial agreement) to TalkTalk's extensive network coverage alongside that of both Virgin and BT Wholesale. This investment has accelerated our growth in a market where Gamma currently has a low penetration and where data access can often be bundled with other products. Business broadband continues to migrate to fibre-based offerings and, as the cost of ethernet falls, this higher capacity product falls within the reach of a larger number of businesses in the SME market, creating a displacement opportunity.

Further extensions of the service are planned and linked to the previously announced investments in the national network. We continue to invest in helping our channel partners succeed in the business market and have now launched a new sophisticated marketing platform - branded Accelerate - to assist them in generating leads and driving sales of Gamma products.

Operational Performance and Security

Our core product platforms exceeded availability targets for the first 6 months of the year, testimony to the comprehensive operational governance we operate to ensure any potential risks to services are understood and mitigated. The 'Gamma Academy' (our online training environment for Channel Partners, which was launched at the end of 2016) has been very well received and over 4,700 individuals have logged on to view training material. The latter is aimed at equipping our channel partners' support teams to deliver the high levels of service demanded by the business market.

The Board regularly reviews the health of our security governance, to ensure appropriate resource and high priority is placed on mitigating risk in this area. The Group subscribes to a number of sources of security intelligence, as well as participating in relevant national working groups. It regularly employs expert third parties to carry out penetration testing against its network, product platforms, online interfaces and employees to ensure high levels of security awareness and that any vulnerabilities are understood and quickly addressed.

Indirect Business Channel

We continue to see plenty of growth and scope for further development in the channel. With the majority of businesses now planning to buy all of their communications services from a single supplier, the channel is in a strong position to offer the supply combination needed for a particular business, offering a clear value-added model. Gamma is positioned to provide the channel with services from the core of its network that either supplement or replace site-based equipment. Our focus remains on being highly relevant to the channel, straightforward to do business with, and continuing to offer the channel exciting products that displace old technology and improve the way businesses can work. The number of partners actively trading with Gamma has increased from 970 at the end of 2016 to 1,023.

Whilst the general focus of the channel remains on the SME market some of our partners are having growing success in the mid-market. Examples of recent successes with our valued added partners include:

- The National Autistics Society via our partner IBT; Gamma is delivering the wide area network to over 150 sites.
- Addison Lee, via our partner Unify Communications; Gamma supplies Cloud PBX (Horizon) for up to 1500 users
- Brooks McDonald investment management services via our partner Ethos; Gamma delivered the Cloud PBX (Horizon) service to over 600 UK staff.
- Blackstar, the UK data centre specialist via our partner G3 Communications; Gamma delivers SIP trunking services to its data customers.
- Homebase serviced by contact centre specialist partner Sabio; Gamma provides resilient cloud inbound services and voice business continuity.

We have increased the resources supporting Systems Integrators (SIs) and Business Process Outsourcers (BPOs) and this is showing early results via partners such as Capita and Atos, whilst Coretx has agreed to consolidate its hosted telephony on to the Horizon cloud PBX platform.

Direct Business Channel

Our Direct Business has had an excellent start to the year with Gamma's Cloud Communication solutions resonating with all market sectors.

Some notable wins in the SME and Enterprise space include:

- itsu the UK food retailer has entered a three year contract with Gamma for a managed data network to its 70 UK locations whilst extending its existing Gamma Cloud PBX service to these locations.
- Savills plc has selected Gamma to deploy a high speed managed data network.
- Stackhouse Poland, a top 10 independent UK insurance broker, will be migrating its entire data, voice and mobility estate to Gamma as part of a three year managed services agreement.
- Care UK, a leading health and social care provider has signed an agreement for Gamma to deploy and manage Gamma's Cloud PBX service, to over 80 sites for a minimum of three years.

The Public Sector also performed well, with contract wins including:

- Macmillan Cancer Support who selected Gamma to provide a fully managed data, voice and mobility solution across its 15 sites and 1,500 staff. This deployment will also see Macmillan adopt an omni-channel contact centre for its cancer support and fund raising activities.
- Manchester University Hospitals NHS Foundation Trust have selected Gamma to provide high resilient SIP trunks to support a number of hospitals across Manchester.
- Next generation housing provider, Your Housing Group, has awarded Gamma a further multi-year contract to deliver and manage a complete data, voice and mobility solution to its extensive estate and workforce.
- Shropshire Council awarded Gamma a 24 month framework contract for the supply of mobile voice and data services to over 2,000 of its workforce.
- Redcar and Cleveland Borough Council and the University of Bath also awarded material contracts to Gamma.

In addition, we are particularly pleased with the level of customer contract extensions and re-signs secured in the first half of 2017 including Dignity plc who have extended their complete managed communications infrastructure agreement with Gamma until late 2020. This demonstrates the high levels of customer satisfaction attained by our team.

Network

The £5m investment in a new, high capacity, core network we announced in 2016 is progressing well, with the optical fibre expected to be handed over to Gamma in Q4 2017, following which a progressive network upgrade will be conducted enabling customer access speeds of 10Gbit/s.

A parallel programme to remove legacy voice equipment and reduce both data centre and ongoing support costs is proceeding well with significant amounts of equipment now decommissioned. Overall this programme, spread over three years, will remove network costs of c £3m p.a. against 2016 levels.

Employees

We were once again pleased to be recognised as one of The Sunday Times "Best 100 Companies to Work For 2017". This is the fifth year in a row that Gamma has been in this index. This has benefit in both enabling us to continue to focus on areas important to employee engagement and to help attract new employees, and graduates in particular.

The number of people in the company grew over the period from 753 to 821 largely to support the growth in sales and customer numbers, and the continued investment in products.

We continue to assist apprentices to gain valuable work experience, to continue their education and to gain nationally recognised qualifications. Apprentices are currently employed in IT, HR, Infrastructure Support, Software Development and Customer Service. We have a good track record of offering permanent employment at the end of the apprenticeships. Expanding opportunities for apprentices across the business remains a priority for Gamma.

Property

We have agreed a lease on a second property in Glasgow to cater for the growth in the organisation. We plan to consolidate all of our Glasgow based staff onto a single site at a later date.

Outlook

The business continues to execute on its stated strategy, with a strong focus of investment in new products for the business market sold primarily through the channel. We see an increased opportunity in particular vertical markets for which we can relatively easily adapt our products (for example, we can allow our Cloud PBX service to inter-work with a CRM system which has a high market share of GP surgeries and this opens up a market for Gamma and its channel). Meanwhile, we see no slowdown as yet in the growth of SIP Trunking or Cloud PBX, and an encouraging upturn in data. The planned Q4 launch of Connect - our first converged fixed and mobile product – marks what we believe will be a turning point in the market that few operators are currently able to fully address.

Whilst the channel remains our primary route to market, our direct business continues to grow successfully, particularly in the larger enterprise and public sector markets where customers often choose to work with the asset owning supplier. We remain very optimistic about the growth prospects for the business.

Bob Falconer
Chief Executive Officer

Financial review

Revenue and gross profit

Indirect business

Revenue from the indirect business in the first half grew from £83.0m in H1 2016 to £88.1m (+6.1%) and gross profit grew from £37.6m to £41.7m – an increase of £4.1m compared to the same period of the previous year. Gross profit from our “growth” products (“growth” products are SIP, Cloud PBX, Inbound, Data and Mobile products) grew by £5.8m whilst there was a reduction of £1.7m from our “traditional” products (calls and lines and our carrier business).

The increase in revenue is all organic and, because sales are all to UK customers and denominated in Sterling the weakness of Sterling compared to the same period last year has no effect on these results.

Revenue from growth product sales increased from £54.9 m to £62.0m (+12.9%) and gross profit grew from £29.1m to £34.9m (+19.9%). The gross margin grew from 53.0% to 56.3% which reflects the fact that the main contributor to this growth was SIP Trunking, which has a higher margin than other products.

The key drivers of growth in our gross profit line continue to be SIP Trunking and Cloud PBX where we have seen volume growth and margins consistent with previous periods but with pressure on margins in some areas. Following infrastructure investments to reduce our cost base, data products also continue to grow well in a more commoditised and price competitive market. Sales of our Inbound product were lower in H1 2017 than H1 2016 which is, in part, due to end users moving to our Cloud PBX service (which generates a higher gross profit per user) and also price pressure. As anticipated, we did enter the period with lower mobile volumes as a result of moving from the Vodafone Thin MVNO to our own Full MVNO, but now that transition is complete, we have now moved back to a position of volume growth and anticipate this continuing.

Direct business

The direct business had a very strong half as the order book (which was very strong at the end of 2016) was rolled out and began to generate revenue. Revenue increased from £21.7m in 2016 to £26.9m (+24.0%) and gross profit from £10.1m to £12.4m (+22.8%). Margin decreased slightly from 46.5% to 46.1% but this was really a mix impact from a sale of equipment at low margin; the underlying margin grew if that “one off” sale were excluded.

The growth was attributable to the growth products and gross profit on these products grew from £8.1m to £10.5m. The business continues to move from selling to smaller customers to larger businesses and the public sector on multi-year deals.

The order book and sales pipeline continue to be strong.

Adjusted operating expenses

Adjusted operating expenses grew from £31.4m (H1 2016) to £34.4m. This was due to a number of factors:

- Ongoing growth in the number of customers buying new products for the first time continues to be a driver of overhead especially in the area of provisioning product to our new enterprise customers.
- Increased investment in product R&D that doesn't meet capitalisation criteria.
- Continued investment in our sales teams.

The above increases were offset to some degree by:

- a reduction in the costs of support of our mobile platform which were high in H1 2016 as we were preparing it for launch; and
- our ongoing programme to reduce the running costs of our network through selective additional investment.

Alternative performance measures

Our policy for adjusted performance measures is set out in Note 2 to the unaudited financial statements.

The tables below reconcile the alternative performance measures used in this document –

2017

| Measure | Statutory basis | Depreciation and amortisation | Share based payment | Tax effect | Other non-recurring items | Adjusted basis |
|---|-----------------|-------------------------------|---------------------|------------|---------------------------|----------------|
| Operating Expenses (£m) | 41.7 | (6.1) | (1.2) | - | - | 34.4 |
| EBITDA (£m) | 18.5 | - | 1.2 | - | - | 19.7 |
| PBT (£m) | 12.5 | - | 1.2 | - | - | 13.7 |
| PAT (£m) | 11.1 | - | 1.2 | (1.2) | - | 11.1 |
| Net cash flows from operating activities (£m) | 14.2 | - | - | 1.1 | - | 15.3 |

2016

| Measure | Statutory basis | Depreciation and amortisation | Share based payment | Tax effect | Other non-recurring items | Adjusted basis |
|---|-----------------|-------------------------------|---------------------|------------|---------------------------|----------------|
| Operating Expenses (£m) | 37.2 | (4.4) | (1.4) | - | - | 31.4 |
| EBITDA (£m) | 14.9 | - | 1.4 | - | - | 16.3 |
| PBT (£m) | 10.6 | - | 1.4 | - | - | 12.0 |
| PAT (£m) | 8.6 | - | 1.4 | (0.5) | - | 9.5 |
| Net cash flows from operating activities (£m) | 11.9 | - | - | 1.9 | - | 13.8 |

The reconciliation of EPS to adjusted EPS for the first six months of the year is shown below (both are shown on a Fully Diluted basis):

| | 2017 pence | 2016 pence |
|--|-------------|-------------|
| EPS | 11.8 | 9.1 |
| Share based payment expense | 1.3 | 1.5 |
| Tax effect associated with share based payment expense | (0.4) | (0.5) |
| Additional effect of dilution | (0.1) | - |
| Non-recurring tax credit due to the conclusion of a previously unresolved tax matter | (1.0) | - |
| Adjusted EPS | 11.6 | 10.1 |

See also note 6 to the unaudited financial statements.

Adjusted EBITDA

The combination of increasing sales of new products and operational improvements means that adjusted EBITDA grew from £16.3m in H1 2016 to £19.7m or 20.9%.

Taxation

The effective tax rate for the first half of 2017 was 11.2%. This rate is however depressed significantly by a non-recurring tax credit of £0.9m which related to a tax overpayment from 2014 and earlier years where the underlying position has only recently been resolved. Taking the credit into account, the underlying effective tax rate for the first half of the year was 18.4% (2016: 18.9%). The tax rate is lower than the statutory rate for the year of 19.25% (2016: 20.00%) because the Group benefits from research and development tax credits.

Cash flows

The cash balance at the end of June 2017 was £28.7m, up fractionally from £28.2m at the end of the previous year. The adjusted net operating cash inflow (i.e. stated before tax payments) for the half was £15.3m which represents 77.7% of adjusted EBITDA for the year (H1 2016: 84.7%).

We continue to turn our trading profit into cash. However, cash conversion from adjusted EBITDA in the half is slightly lower than originally guided because Gamma has taken the opportunity to prepay some suppliers in return for improved commercial terms.

Capital spend for the first half was £9.1m, which is an increase from £7.6m in the comparative period. This is discussed in detail below.

The Group continues to be debt free and a number of lenders have indicated that they would be willing to support the Group with debt were it to be required for capital expenditure programmes or M&A activity.

Capital expenditure

The Group spent £9.1m (H1 2016: £7.6m) on capital which was split as follows.

Regular capital expenditure of £8.6m (being the normal levels of capital expenditure that Gamma spends to run the business) (H1 2016: £6.8m) -

- £3.0m was on enhancement, replacement, increasing capacity and development of the core network as well as other minor items such as IT and fixtures and fittings (H1 2016: £2.6m).
- £0.5m was the capitalisation of development costs incurred during the year (H1 2016: £0.5m).
- £5.1m was on customer premises equipment; this is "success based" expenditure and has increased in line with sales in our data and Cloud PBX products (H1 2016: £3.7m). (See also the notes on implementation of IFRS15 below).

Additional capital expenditure which was spent to develop new products was £0.5m (H1 2016: £0.8m) which was spent on augmenting the mobile platform.

At the time of our final results for 2016, we announced that we expect to spend an additional £5m in 2017 on our new national network which will replace our existing fibre ring. None of this was spent in the first half and therefore will largely occur in the second half of 2017 with a small amount in 2018. This will provide Gamma with a core infrastructure for the next twenty-five years.

Adjusted EPS

Adjusted EPS increased from 10.1p to 11.6p (14.9%). The growth in adjusted EPS is slightly behind that of adjusted EBITDA due to depreciation and amortisation in the half increasing from £4.4m in 2016 to £6.1m. This is driven by the investment programme and success based capital spend described above.

Dividends

The Board has proposed an interim dividend of 2.8p (2016: 2.5p). This is an increase of 12% and is in line with our progressive dividend policy.

The interim dividend is payable on Thursday 19 October 2017 to shareholders on the register as at Friday 22 September 2017.

New accounting standards

Gamma has been working on the new accounting standards relating to revenue recognition (IFRS 15) and leases (IFRS 16). Our assessment is discussed in Note 2 to the interim financial statements. We do not expect EPS to be materially affected.

Andrew Belshaw
Chief Financial Officer

MANAGEMENT STATEMENT

This Interim Management Report (IMR) has been prepared solely to provide additional information to shareholders to assess the Group's strategies and the potential for those strategies to succeed. The IMR should not be relied on by any other party or for any other purpose.

The IMR contains certain forward-looking statements. These statements are made by the directors in good faith based on the information available to them up to the time of their approval of this report but such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information.

RESPONSIBILITY STATEMENT

We confirm that to the best of our knowledge:

- the condensed set of interim financial statements has been prepared in accordance with IAS34 "Interim Financial Reporting";
- the interim management report includes a fair review of the information required by DTR 4.27R (indication of important events during the first six months and description of principal risks and uncertainties for the remaining six months of the year); and
- the interim management report includes a fair review of the information required by DTR 4.28R (disclosure of related party transactions and changes therein).

By the order of the board
4 September 2017

INDEPENDENT REVIEW REPORT TO GAMMA COMMUNICATIONS PLC

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 which comprises the unaudited condensed consolidated statement of comprehensive income, the unaudited condensed consolidated statement of financial position, the unaudited condensed consolidated statement of cash flows, the unaudited condensed consolidated statement of changes in equity and related notes 1 to 11. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company 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. Our work has been undertaken so that we might state to the company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the AIM Rules of the London Stock Exchange.

As disclosed in note 1, the annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting," as adopted by the European Union.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

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 inquiries, 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.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the AIM Rules of the London Stock Exchange.

Deloitte LLP
Statutory Auditor
Reading, United Kingdom
4 September 2017

Condensed consolidated unaudited statement of comprehensive income

For the six month period ended 30 June 2017

| | Notes | Six months ended 30 June 2017 £m Unaudited | Six months ended 30 June 2016 £m Unaudited | Year ended 31 December 2016 £m Audited |
|--|-------|--|--|--|
| Revenue | 3 | 115.0 | 104.7 | 213.5 |
| Cost of sales | | (60.9) | (57.0) | (114.7) |
| Gross profit | | 54.1 | 47.7 | 98.8 |
| Operating expenses | | (41.7) | (37.2) | (77.4) |
| Operating profit before share based payment, depreciation, and non- recurring items (adjusted EBITDA) | | 19.7 | 16.3 | 34.2 |
| Share based payment expense | | (1.2) | (1.4) | (2.9) |
| Operating profit before depreciation and amortisation | | 18.5 | 14.9 | 31.3 |
| Depreciation and amortisation | | (6.1) | (4.4) | (9.9) |
| Profit from operations | | 12.4 | 10.5 | 21.4 |
| Interest income | | 0.1 | 0.1 | 0.2 |
| Profit before tax | | 12.5 | 10.6 | 21.6 |
| Tax expense | 5 | (1.4) | (2.0) | (3.9) |
| Profit after tax | | 11.1 | 8.6 | 17.7 |
| Total comprehensive income attributable to the owner of the parent | | 11.1 | 8.6 | 17.7 |
| Earnings per share | | | | |
| Basic per ordinary share (pence) | | 12.0 | 9.5 | 19.4 |
| Fully diluted per ordinary share (pence) | | 11.8 | 9.1 | 18.8 |

Condensed consolidated unaudited statement of financial position

At 30 June 2017

| | Notes | 30 June 2017 £m Unaudited | 30 June 2016 £m Unaudited | 31 December 2016 £m Audited |
|---|-------|---------------------------------|---------------------------------|--------------------------------------|
| Assets | | | | |
| Non-current assets | | | | |
| Property, plant and equipment | 7 | 36.7 | 26.7 | 33.5 |
| Intangible assets | | 9.8 | 10.3 | 10.0 |
| Trade and other receivables | | 1.0 | - | - |
| Deferred tax asset | | 1.8 | 2.0 | 1.8 |
| | | 49.3 | 39.0 | 45.3 |
| Current assets | | | | |
| Inventories | | 4.0 | 2.6 | 3.0 |
| Trade and other receivables | | 51.1 | 39.8 | 39.9 |
| Cash and cash equivalents | | 28.7 | 27.8 | 28.2 |
| | | 83.8 | 70.2 | 71.1 |
| Total assets | | 133.1 | 109.2 | 116.4 |
| Liabilities | | | | |
| Non-current liabilities | | | | |
| Provisions | | 2.0 | 1.4 | 1.9 |
| Deferred tax liability | | 0.2 | 0.4 | 0.2 |
| | | 2.2 | 1.8 | 2.1 |
| Current liabilities | | | | |
| Trade and other payables | | 40.8 | 32.6 | 32.5 |
| Current tax liability | | 2.6 | 2.4 | 1.6 |
| | | 43.4 | 35.0 | 34.1 |
| Total liabilities | | 45.6 | 36.8 | 36.2 |
| Issued capital and reserves attributable to owners of the parent | | | | |
| Share capital | 8 | 0.2 | 0.2 | 0.2 |
| Share premium reserve | | 3.8 | 3.7 | 3.8 |
| Merger reserve | | 2.3 | 2.3 | 2.3 |
| Share option reserve | | 2.3 | 2.7 | 3.5 |
| Investment in own shares | | (0.8) | (0.8) | (0.8) |
| Retained earnings | | 79.7 | 64.3 | 71.2 |
| Total equity | | 87.5 | 72.4 | 80.2 |
| Total equity and liabilities | | 133.1 | 109.2 | 116.4 |

Condensed consolidated unaudited statement of cash flows

For the six month period ended 30 June 2017

| | Notes | Six months ended 30 June 2017 £m Unaudited | Six months ended 30 June 2016 £m Unaudited | Year ended 31 December 2016 £m Audited |
|--|-------|--|--|--|
| Cash flows from operating activities | | | | |
| Profit for the period before tax | | 12.5 | 10.6 | 21.6 |
| Adjustments for: | | | | |
| Depreciation of property, plant and equipment | 7 | 5.4 | 3.8 | 8.6 |
| Amortisation of intangible assets | | 0.7 | 0.6 | 1.3 |
| Share based payment expense | | 1.2 | 1.4 | 2.9 |
| Interest income | | (0.1) | (0.1) | (0.2) |
| | | 19.7 | 16.3 | 34.2 |
| Increase in trade and other receivables | | (11.5) | (7.4) | (7.3) |
| Increase in inventories | | (1.0) | (0.3) | (0.7) |
| Increase in trade and other payables | | 8.1 | 5.2 | 4.6 |
| Increase in provisions and employee benefits | | - | - | 0.5 |
| | | (1.1) | (1.9) | (4.8) |
| Taxes paid | | | | |
| | | | | |
| Net cash flows from operating activities | | 14.2 | 11.9 | 26.5 |
| Investing activities | | | | |
| Purchases of property, plant and equipment | | (8.6) | (7.1) | (18.7) |
| Expenditure on development costs | | (0.5) | (0.5) | (0.9) |
| Repayment of loans made to individuals to subscribe for shares | | - | 2.6 | 2.6 |
| Interest received | | 0.1 | 0.1 | 0.2 |
| Net cash used in investing activities | | (9.0) | (4.9) | (16.8) |
| Financing activities | | | | |
| Share issues | | - | - | 0.1 |
| Investment in own shares | | - | - | - |
| Dividends paid | | (4.7) | (4.0) | (6.4) |
| Net cash used in financing activities | | (4.7) | (4.0) | (6.3) |
| Net increase in cash and cash equivalents | | 0.5 | 3.0 | 3.4 |
| Cash and cash equivalents at beginning of period | | 28.2 | 24.8 | 24.8 |
| Cash and cash equivalents at end of period | | 28.7 | 27.8 | 28.2 |

Condensed consolidated unaudited statement of changes in equity

For the six month period ended 30 June 2017

| | Share capital £m | Share premium £m | Merger reserve £m | Share option reserve £m | Investment in own shares £m | Retained earnings £m | Total equity £m |
|-------------------------------------|---------------------|---------------------|----------------------|-------------------------------|-----------------------------------|----------------------------|--------------------|
| 1 January 2017 | 0.2 | 3.8 | 2.3 | 3.5 | (0.8) | 71.2 | 80.2 |
| Issue of shares | - | - | - | (2.1) | - | 2.1 | - |
| Recognition of share based payments | - | - | - | 0.9 | - | - | 0.9 |
| Dividends paid | - | - | - | - | - | (4.7) | (4.7) |
| Transaction with owners | - | - | - | (1.2) | - | (2.6) | (3.8) |
| Profit for the period | - | - | - | - | - | 11.1 | 11.1 |
| Total comprehensive income | - | - | - | - | - | 11.1 | 11.1 |
| 30 June 2017 | 0.2 | 3.8 | 2.3 | 2.3 | (0.8) | 79.7 | 87.5 |
| 1 January 2016 | 0.2 | 3.7 | 2.3 | 3.8 | (0.8) | 57.5 | 66.7 |
| Issue of shares | - | - | - | (2.2) | - | 2.2 | - |
| Recognition of share based payments | - | - | - | 1.1 | - | - | 1.1 |
| Dividends paid | - | - | - | - | - | (4.0) | (4.0) |
| Transaction with owners | - | - | - | (1.1) | - | (1.8) | (2.9) |
| Profit for the period | - | - | - | - | - | 8.6 | 8.6 |
| Total comprehensive income | - | - | - | - | - | 8.6 | 8.6 |
| 30 June 2016 | 0.2 | 3.7 | 2.3 | 2.7 | (0.8) | 64.3 | 72.4 |

Notes forming part of the condensed consolidated unaudited interim financial information

For the six month period ended 30 June 2017

1. Basis of preparation

The unaudited interim consolidated financial information for the six months ended 30 June 2017 has been prepared following the recognition and measurement principles of IFRS as adopted by the European Union and in accordance with International Accounting Standard 34 Interim Financial Reporting ('IAS34'). The interim consolidated financial information does not include all the information and disclosures required in the annual financial information, and should be read in conjunction with the audited statutory financial statements for the year ended 31 December 2016.

The condensed interim financial information contained in this interim statement does not constitute financial statements as defined by section 434(3) of the Companies Act 2006. The condensed interim financial information has not been audited. The financial information for the year ended 31 December 2016 is derived from the audited statutory financial statements for the year ended 31 December 2016, which were unqualified and did not contain any statement under section 498(2) or 498(3) of the Companies Act 2006. The comparative financial information for the period ended 30 June 2016 does not constitute statutory accounts for that period.

There are no additional standards or interpretations applicable to the Group for the accounting period commencing 1 January 2017 for adoption.

In preparing the condensed interim financial information the Directors have considered the Group's financial projections, borrowing facilities and other relevant financial matters, and the Board is satisfied that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason the Directors continue to adopt the going concern basis in preparing the financial information. The condensed financial information for the six month period were approved by the board on 4 September 2017.

2. Accounting policies

The accounting policies adopted are consistent with those followed in the preparation of the audited statutory financial statements for the year ended 31 December 2016.

Taxation

Taxes on income in the interim periods are accrued using the tax rate that is expected apply to total annual earnings.

New accounting standards

Three amendments to IFRSs became effective for the financial year beginning on 1 January 2017. The changes comprise amendments to IAS 7 (Cash Flow Statements) and IAS 12 (Income Taxes) and the annual improvements project 2014-2016 relating to IFRS 12 (Disclosure of interests in other entities).

The amendments to IAS 7 (Cash Flow Statements) requires a disclosure of changes in liabilities arising from financing activities. This amendment is not required for interim financial statements and has not yet been endorsed by the European Union. The Directors expect to provide these additional disclosures in the Annual Report and Accounts for the year ended 31 December 2017.

The changes to IAS 12 (Income Taxes) and IFRS 12 (Disclosure of interests in other entities) do not have an impact on the Group's financial statements.

There are two new accounting standards which will come into effect shortly and are expected to have an effect on companies within our industry (and many others). These are IFRS15 “Revenue from Contracts with Customers” and IFRS16 “Leases”. These standards are expected to have a noticeable effect on both the timing of recognition of revenue items and also where revenue and costs appear within the Statement of Comprehensive Income.

IFRS 9 (Financial Instruments) has also been revised but this is not expected to have a material effect on the Group.

Gamma intends to adopt these in the Financial Statements for the year ended 31 December 2018 (i.e. the transition date will be 1 January 2018). Therefore IFRS16 will be early adopted.

Implementation of IFRS 15 and 16

Gamma has been working with its auditors and other advisors to consider how these new standards will affect the results. Whilst Gamma does not offer a full reconciliation of the 2017 interim results from the former standards to the new standards, we take this opportunity to set out below a summary of how the changes in standards are likely to affect Gamma’s financial statements in 2018 and beyond.

In summary –

- We do not expect significant changes in the timing of recognition of overall earnings.
- We do not expect EPS to be materially affected.
- We expect material changes to EBITDA as items which were shown as depreciation will now be shown within operating profit and vice-versa. Gamma’s history of strong EBITDA growth would have occurred under either the new or the old accounting standards.
- We will provide a full reconciliation with the year end results.

IFRS15 – Revenue from Contracts with Customers

Gamma (working with its advisors) has identified four areas where the new standard will change existing accounting policies.

Sales of Cloud PBX via the “Upfront Subscription” model

Most Channel Partners purchase our Cloud PBX on a “per seat, per month” basis (i.e. the same fee is charged each month for each seat). However, some purchase the product by paying an “up front” subscription followed by a reduced monthly amount. Historically, the revenue for the subscription has been taken at the time of sale. However, IFRS 15 will require this revenue to be amortised over the likely length of usage of the product. Sales of this type in the first half of 2017 totalled £3.2m which has been recognised as revenue in these interim statements. Under IFRS15 this would have been deferred and recognised over (on average) 48 months. Note that revenue recognised in previous periods would also be deferred into the first half of 2017 under IFRS 15 and therefore (assuming that sales do not fluctuate significantly) the effect on revenues overall is not expected to be significant.

Were sales of this variant of the Cloud PBX product to fluctuate significantly in the second half of 2017 and 2018 then the transitional adjustment would be greater than we presently expect.

Customer Premises Equipment

When Gamma sells our Cloud PBX product or our Data products, customers are allowed to use a piece of equipment (a phone or a router) which enhances the service experience. Historically, these pieces of equipment (known as Customer Premises Equipment or CPE) have been capitalised, held as tangible assets on Gamma’s Statement of Financial Position and amortised over the length of the contract. IFRS 15 requires that they be treated as separate sales and therefore at the inception of the service when the CPE is shipped, an accrued revenue balance is created to offset the cost of the asset which is taken to cost of sales. This accrued revenue balance is released over the length of the contract. The effect of this is that the debit to the Statement of Comprehensive Income which had historically gone through the “depreciation” line as a monthly charge over the expected useful life of the asset will now be reported monthly as a reduction in revenue. There is also a small timing difference because the original sale will be made at a small margin (typically between 5-10%) which has the effect of accelerating the recognition of a small amount of profit on the sale.

In the first half of 2017 the amount of CPE capitalised was £5.1m and the depreciation charge was £2.4m. The adoption of IFRS15 would have a small effect on EPS but a significant negative impact on EBITDA (because depreciation has, in effect, been replaced by “negative revenue”). As for the above, the conclusion that there is small effect on EPS relies on the assumption that provision of CPE is in line with the current trends.

Installation costs

In our Direct Business, Gamma will sometimes incur “installation costs” at the start of a contract which are not passed on to a customer. These costs are taken as they are incurred. Under IFRS 15, they will be allocated to the initial equipment sale and the ongoing service revenues (the latter element will be capitalised and amortised over the length of the contract). This has the effect of recognising profit at an earlier stage of the contract than under the present policy.

The level of installation costs in the first half of 2017 was £2.4m. The impact is not expected to be significant. It may be slightly positive or negative (for both EBITDA and EPS) depending on the level of installation costs on new contracts won compared to corresponding amounts in previous years.

Commission payments to sales staff

In our Direct Business, when a member of the sales team is responsible for winning a multi-year term contract they will receive commission. Historically, this was expensed at the time it was paid. IFRS15 requires that this be capitalised and amortised over the length of the contract which has the effect of increasing profit in the period in which the commission is paid (and therefore decreasing it in future periods).

The level of such commission paid in the first half of 2017 was £1.2m. Because of the growth of the Direct Business, the amounts paid are increasing year-on-year and hence the impact of this change will be to increase EPS and EBITDA but not significantly.

IFRS16

IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is twelve months or less or the underlying asset has a low value.

Gamma has a number of leased properties for which the accounting will be different in future. The effect on the Statement of Comprehensive Income is that costs which had previously been shown as “operating expenses” will now be shown as depreciation and a small amount of interest (the latter driven by the fact that the future liability is discounted). The effect of discounting will also skew the lease costs towards the start of a lease and this effect is most marked when interest rates are high.

Total lease payments which will be treated in this way were £0.8m in the first half of 2017. This change is unlikely to affect EPS (unless interest rates increase substantially such that the discounting element becomes material) but will increase EBITDA as costs which were shown as operating expenses become, in effect, depreciation.

Taxation in respect of new accounting standards

We expect the overall cumulative effect on transition will be a reduction to retained earnings and this will result in a one-off tax benefit in 2018. This one-off benefit will be taken to reserves but will result in reduced payments for Corporation Tax in 2018. This has not yet been quantified.

Judgements and estimates

Some of the significant accounting policies require management to make difficult, subjective or complex judgements or estimates. The policies which management consider critical because of the level of complexity, judgement or estimation involved in their application and their impact on the financial Information are:

- Revenue recognition
- Taxation
- Leasehold dilapidations
- Capitalisation of internal development costs
- Onerous lease provisions

Adjusted measures

Adjustments to EBITDA, PBT, EPS and net operating cash inflow have been presented because the Group believes that adjusted measures provide valuable additional information for users of the financial statements in assessing the Group's performance. Moreover, they provide information on the performance of the business that management is more directly able to influence and on a basis comparable from year to year.

For example, to ensure trading performance year-on-year is not flattered by the unwinding of an exceptional share award made at the time of the float, Share Based Payments are removed from adjusted EBITDA, PBT and EPS to allow a user to obtain a better understanding of the trading performance.

Share based payment expense

The adjusted EBITDA excludes Share Based Payment expense because the historical charges are inflated by significant levels of awards made at IPO and have reduced significantly period on period. The charge includes options being issued to senior management, an SAYE and a SIP scheme offered to all staff, and the costs of Employer's National Insurance on share option gains. Because of the special float award made in 2014, the Share Based Payment charges have decreased year-on-year and this leads to increases in EBITDA, PBT and EPS which are not reflective of the business performance but are merely reflective of the fact that lower levels of options have been awarded post float. Therefore management excludes Share Based Payments from the adjusted figures to ensure that the trading performance of the business is properly understood. This exclusion will be reviewed in future years and when the levels of option awards have stabilised will be removed from the adjustments.

Other non-recurring items

Non-recurring items are those which are considered significant by virtue of their nature, size or incidence, and are presented separately in the Statement of Comprehensive Income to enable a full understanding of the Group's financial performance.

There were none in the period or comparative period which affected EBITDA or PBT.

Depreciation and amortisation

Depreciation and amortisation relate to assets which were acquired by the Group, mainly in previous periods. They are omitted from adjusted operating expenses to allow a user to see how costs which management can control in the short term have varied from period to period.

Brexit

Britain's impending departure from the EU creates uncertainty and will result in changes for some businesses. This is likely to produce both risks and opportunities for Gamma. The main risks anticipated are; possible reduction in economic activity across the UK, possible long term reduction in the size of the financial sector in London, possible increases in costs of international call termination and international roaming charges. Gamma will manage its pricing policies and its contractual arrangements with customers and suppliers in the light of the evolution of the government's Brexit negotiations.

3. Segment information

The Group has two operating segments:

- Indirect – This division sells Gamma's traditional and growth products and services to channel partners and contributed 76.6% (2016: 79.3%) of the Group's external revenue; and
- Direct – This division sells Gamma's traditional and growth products and services to end users in the SME, Enterprise and public sectors. They contributed 23.4% (2016: 20.7%) of the Group's external revenues.

There are no material non UK segments and no material non-current assets outside the UK.

Both operating segments sell a combination of traditional products (which is mainly voice traffic from which revenues are derived from channel partners and other carriers as well as rentals for wholesale lines) and growth products (which consist of IP voice traffic, rental income derived from SIP Trunking, hosted IP voice systems and Gamma's hosted inbound product and data products).

Factors that management used to identify the Group's reportable segments

The Group's reportable segments are strategic business units that offer products and services into different markets. They are managed separately because each business requires different marketing strategies and are reported separately to the Board and management team.

Measurement of operating segment profit or loss, assets and liabilities

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies.

The Group evaluates performance on the basis of profit or loss from operations but excluding the effects of share based payments.

Inter-segment sales are priced along the same lines as sales to external customers, with an appropriate discount being applied to encourage use of Group resources at a rate acceptable to local tax authorities. This policy was applied consistently throughout the current and prior period.

| | Indirect £m | Direct £m | Total £m |
|--|----------------|--------------|--------------|
| Period to 30 June 2017 | | | |
| Traditional products and services | 26.1 | 5.8 | 31.9 |
| Growth (being strategic and enabling) products and services | 62.0 | 21.1 | 83.1 |
| Total revenue from external customers | 88.1 | 26.9 | 115.0 |
| <i>Inter-segment revenue</i> | 6.7 | - | 6.7 |
| Traditional products and services | 6.8 | 1.9 | 8.7 |
| Growth (being strategic and enabling) products and services | 34.9 | 10.5 | 45.4 |
| Total gross profit | 41.7 | 12.4 | 54.1 |
| Segment operating profit before share based payment, depreciation, amortisation and non-recurring items | 13.8 | 5.9 | 19.7 |
| Share based payment expense | (1.2) | - | (1.2) |
| Segment EBITDA | 12.6 | 5.9 | 18.5 |
| Depreciation and amortisation | (5.6) | (0.5) | (6.1) |
| Segment profit | 7.0 | 5.4 | 12.4 |
| Interest income | 0.1 | - | 0.1 |
| Tax | (0.6) | (0.8) | (1.4) |
| Group profit after tax | 6.5 | 4.6 | 11.1 |

External revenue of customers has been derived principally from the United Kingdom and no single customer contributes more than 10% of revenue.

| | Indirect £m | Direct £m | Total £m |
|--|----------------|--------------|-------------|
| Additions to non-current assets | 8.4 | 0.7 | 9.1 |
| Reportable segment assets | 116.5 | 16.6 | 133.1 |
| Reportable segment liabilities | 37.1 | 8.5 | 45.6 |

| | Indirect £m | Direct £m | Total £m |
|--|----------------|--------------|--------------|
| Period to 30 June 2016 | | | |
| Traditional products and services | 28.1 | 5.3 | 33.4 |
| Growth (being strategic and enabling) products and services | 54.9 | 16.4 | 71.3 |
| Total revenue from external customers | 83.0 | 21.7 | 104.7 |
| <i>Inter-segment revenue</i> | 7.3 | - | 7.3 |
| Traditional products and services | 8.5 | 2.0 | 10.5 |
| Growth (being strategic and enabling) products and services | 29.1 | 8.1 | 37.2 |
| Total gross profit | 37.6 | 10.1 | 47.7 |
| Segment operating profit before share based payment, depreciation, amortisation and non-recurring items | 11.8 | 4.5 | 16.3 |
| Share based payment expense | (1.4) | - | (1.4) |
| Segment EBITDA | 10.4 | 4.5 | 14.9 |
| Depreciation and amortisation | (4.0) | (0.4) | (4.4) |
| Segment profit | 6.4 | 4.1 | 10.5 |
| Interest income | 0.1 | - | 0.1 |
| Tax | (1.2) | (0.8) | (2.0) |
| Group profit after tax | 5.3 | 3.3 | 8.6 |

External revenue of customers has been derived principally from the United Kingdom and no single customer contributes more than 10% of revenue.

| | Indirect £m | Direct £m | Total £m |
|---------------------------------|----------------|--------------|-------------|
| Additions to non-current assets | 7.3 | 0.3 | 7.6 |
| Reportable segment assets | 77.1 | 32.1 | 109.2 |
| Reportable segment liabilities | 14.9 | 21.9 | 36.8 |

4. Non-recurring items

There were no non-recurring items in either period affecting EBITDA or PBT.

5. Taxation on profit on ordinary activities

Tax expense is recognised based on management's best estimate of the weighted average annual tax rate expected for the full year. The estimated average annual tax rate used for the year to 31 December 2017 is 18.4% (the estimated tax rate for the first half to 30 June 2016 was 18.9%).

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

| | Six months ended 30 June 2017 £m | Six months ended 30 June 2016 £m |
|---|---|---|
| Current tax expense | | |
| Current tax on profits for the year | 2.4 | 2.1 |
| Adjustment in respect of prior year | (0.9) | - |
| Total current tax | 1.5 | 2.1 |
| Deferred tax expense | | |
| Origination and reversal of temporary differences | (0.1) | (0.1) |
| Total tax expense | 1.4 | 2.0 |

The reasons for the difference between the actual tax charge for the year and the standard rate of corporation tax in the United Kingdom applied to profits for the year are as follows:

| | Six months ended 30 June 2017 £m | Six months ended 30 June 2016 £m |
|--|---|---|
| Profit before income taxes | 12.5 | 10.6 |
| Expected tax charge based on the standard rate of United Kingdom corporation tax at the domestic rate of 19.25% (2016: 20.25%) | 2.4 | 2.1 |
| Additional deduction for R&D expenditure | (0.1) | (0.1) |
| Adjustment in respect of prior year | (0.9) | - |
| Total tax expense | 1.4 | 2.0 |

The Finance Act 2016 includes provision for the main rate of corporation tax to reduce to 17% for the year beginning 1 April 2020.

6. Adjusted earnings per share and dividends

Adjusted earnings per share

The calculation of basic earnings per Ordinary Share is based on a profit after tax of £11.1 m for the six months ended 30 June 2017 (Six months ended 30 June 2016: £8.6m) and 92,239,933 Ordinary Shares for the six months ended 30 June 2017 (Six months ended 30 June 2016: 90,799,608 Ordinary Shares), being the weighted average number of Ordinary Shares in issue during the period.

The fully diluted earnings per Ordinary Share is calculated by including in the weighted average number of shares the dilutive effect of potential Ordinary Shares related to committed share options. For the six months ended 30 June 2017 the fully diluted Ordinary Shares were based on 94,193,010 Ordinary Shares (Six months ended 30 June 2016: 94,286,518) that included 1,953,077 potential Ordinary Shares (Six months ended 30 June 2016: 3,486,910).

The following reflects the income and share data used in the calculation of adjusted earnings per share computations before share based payments, one-off costs and their associated tax effect.

| | Six months ended 30 June 2017 £m Unaudited | Six months ended 30 June 2016 £m Unaudited |
|--|--|--|
| Profit for the year | 11.1 | 8.6 |
| Tax adjustment in respect of prior years | (0.9) | - |
| Share based payment costs | 1.2 | 1.4 |
| Less tax benefit associated with share based payment costs | (0.3) | (0.5) |
| Adjusted profit after tax for the year | 11.1 | 9.5 |

The adjusted fully diluted earnings per Ordinary Share is calculated by including in the weighted average number of shares the dilutive effect of all potential Ordinary Shares as management believe they will all be exercised. For the six months ended 30 June 2017 the fully diluted Ordinary Shares were based on 95,326,426 Ordinary Shares (Six months ended 30 June 2016: 94,395,910) that included 3,086,493 potential Ordinary Shares (Six months ended 30 June 2016: 3,596,302).

| | Six months ended 30 June 2017 No. Unaudited | Six months ended 30 June 2016 No. Unaudited |
|---|---|---|
| EPS | | |
| Weighted average number of Ordinary Shares for basic earnings per share | 92,239,933 | 90,799,608 |
| Effect of dilution resulting from share options | 1,953,077 | 3,486,910 |
| Weighted average number of Ordinary Shares adjusted for the effect of dilution | 94,193,010 | 94,286,518 |
| Adjusted EPS | | |
| Weighted average number of Ordinary Shares for basic earnings per share | 92,239,933 | 90,799,608 |
| Effect of dilution resulting from share options | 3,086,493 | 3,596,302 |
| Weighted average number of Ordinary Shares adjusted for the effect of dilution | 95,326,426 | 94,395,910 |
| Adjusted earnings per Ordinary Share – basic (pence) | 12.0 | 10.5 |
| Adjusted earnings per Ordinary Share – fully diluted (pence) | 11.6 | 10.1 |

For statutory Earnings Per Share, the number of shares used for the fully diluted calculation is prescribed by IFRS 2. For adjusted Earnings Per Share, the Company produces a calculation formulated on management's judgement of the number of options which will vest based on full management forecasts and budgets.

There have been no material transactions involving Ordinary Shares or potential shares between the reporting date and the date of completion of the financial statements.

Dividends

A final dividend of 5.0p was paid on the 19 June 2017 (2016: 4.4p).

The Board have declared an interim dividend of 2.8p per share payable on 19 October 2017 to shareholders on the register as at 22 September 2017. In the prior year an interim dividend of 2.5p was paid

7. Property, plant and equipment

| | Network assets £m | Customer Premises equipment £m | Computer equipment £m | Fixtures and fittings £m | Total £m |
|------------------------|-------------------------|---|-----------------------------|--------------------------------|-------------|
| Cost | | | | | |
| At 1 January 2017 | 54.5 | 13.3 | 6.2 | 0.7 | 74.7 |
| Additions | 3.1 | 5.1 | 0.3 | 0.1 | 8.6 |
| Disposals | - | (0.5) | - | - | (0.5) |
| At 30 June 2017 | 57.6 | 17.9 | 6.5 | 0.8 | 82.8 |
| Depreciation | | | | | |
| At 1 January 2017 | 33.6 | 4.0 | 3.4 | 0.2 | 41.2 |
| Charge for the period | 2.4 | 2.4 | 0.5 | 0.1 | 5.4 |
| Disposals | - | (0.4) | - | (0.1) | (0.5) |
| At 30 June 2017 | 36.0 | 6.0 | 3.9 | 0.2 | 46.1 |
| Net book value | | | | | |
| At 1 January 2017 | 20.9 | 9.3 | 2.8 | 0.5 | 33.5 |
| At 30 June 2017 | 21.6 | 11.9 | 2.6 | 0.6 | 36.7 |
| Cost | | | | | |
| At 1 January 2016 | 45.9 | 5.8 | 4.6 | 0.5 | 56.8 |
| Additions | 2.5 | 3.7 | 0.8 | 0.1 | 7.1 |
| Disposals | - | (0.4) | - | (0.1) | (0.5) |
| At 30 June 2016 | 48.4 | 9.1 | 5.4 | 0.5 | 63.4 |
| Depreciation | | | | | |
| At 1 January 2016 | 29.4 | 1.7 | 2.2 | 0.1 | 33.4 |
| Charge for the period | 1.9 | 1.3 | 0.5 | 0.1 | 3.8 |
| Disposals | - | (0.4) | - | (0.1) | (0.5) |
| At 30 June 2016 | 31.3 | 2.6 | 2.7 | 0.1 | 36.7 |
| Net book value | | | | | |
| At 1 January 2016 | 16.5 | 4.1 | 2.4 | 0.4 | 23.4 |
| At 30 June 2016 | 17.1 | 6.5 | 2.7 | 0.4 | 26.7 |

The estimated cost of the property, plant and equipment which the Group is contractually committed to purchase at 30 June 2017 is £1.6m (30 June 2016: £nil).

8. Share capital

| | 2017 Number | 2017 £m |
|---|-------------------|------------|
| 1 January 2017 | | |
| Ordinary Shares of £0.0025 each | 91,751,499 | 0.2 |
| | Number | Notes |
| 1 January 2017 | 91,751,499 | |
| 27 March 2017 | 272,992 | (a) |
| 10 May 2017 | 1,224,949 | (a) |
| 30 June 2017 | 93,249,440 | |
| (a) Ordinary shares were issued to satisfy options which have been exercised. | | |
| | 2017 Number | 2017 £m |
| 30 June 2017 | | |
| Ordinary Shares of £0.0025 each | 93,249,440 | 0.2 |

9. Related party transactions

Dividends totalling £0.4m (being the final dividend for 2016) were paid in the first half of the year in respect of ordinary shares held by the Company's directors (2016: £0.3m).

10. Events after the reporting date

There were no reportable events after the balance sheet date.

11. Ultimate controlling party

There is no ultimate controlling party. Gamma Communications plc is the ultimate controlling party of the Gamma Communications Group.