NCC Group

Trading update for H1 with full year guidance – continuing confidence in long term outlook

NCC Group plc (LSE: NCC or "the Group"), the independent global cyber security and risk mitigation expert, today publishes a trading update for the first six months of the financial year to 30 November 2016 which follows the Group's four-month trading update on 20 October 2016.

Highlights

- Group revenues increased by 35% (November 2015: 50%) to £125.8m (November 2015: £93.5m). Organic growth of 18% (November 2015: 17%)
  - Assurance Division revenue increased by 42% (November 2015: 57%) to £104.8m (November 2015: £73.8m) - organic growth of 21% (November 2015: 17%)
  - Escrow Division revenue increased by 14% (November 2015: 7%) to £18.7m (November 2015: £16.4m)
- Group adjusted EBITDA* increased by 15% to £21.3m (November 2015: £18.5m)
- Adjusted EBITDA* for the full year to 31 May 2017 is expected to be in the range of £45.5m to £47.5m - showing growth of up to 5% year on year
  - H1:H2 adjusted EBITDA expected split will be approximately 46%:54% based on the midpoint of £46.5m

* The adjustments include the transactions costs of the acquisitions of £0.6m and the losses incurred in Domain Services as the winding down process completes.

Rob Cotton, Group Chief Executive, comments:

"We have continued to see strong organic growth across the business, particularly in Assurance, in the first half of the current financial year with adjusted EBITDA up 15%.

"In our trading update of 20 October 2016, we stated that we had seen three large unrelated contract cancellations in quick succession and one deferral in the Assurance division but it was too early to quantify the likely impact. We can today update the market with full year guidance.

"Whilst our forward visibility remains strong, we now do not expect to make up this profitability in the current financial year. We therefore anticipate year-end adjusted EBITDA* to grow by up to 5% and be in the range of £45.5m to £47.5m – less than earlier expectations.

"Although disappointing, these contract cancellations do not reflect any structural change in our Assurance business. We will continue to exploit our leading worldwide position and are expecting to see solid organic growth in both this and in future years in fast growing markets.

"The long-term outlook for our Assurance business is unchanged and we remain confident in the future prospects for both of our divisions. Overall the Group's forward order books and renewals have increased to £112.8m from the £108.8m level published on 20 October 2016."

There will be an analyst conference call at 8.30am – please contact Hannah Franklin at hannah.franklin@instinctif.com or on telephone 020 7457 2020 for details.

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Financial – six months ended 30 November 2016

Group revenues increased by 35% (November 2015: 50%) to £125.8m (November 2015: £93.5m).

Organic growth across the Group was 18% (November 2015: 17%) after taking account of the effects of the recent acquisitions of Fox-IT in December 2015, Payment Software Company Inc. ("PSC") who joined the Group on 28 September 2016 and Virtual Security Research LLC ("VSR") on 11 November 2016.

Group adjusted EBITDA increased by 15% to £21.3m (November 2015: 18% and £18.5m).

Interest charged was £0.6m (November 2015: £0.8m) depreciation was £2.5m (November 2015: £1.6m) and amortisation of capitalised software and development costs was £1.6m (November 2015: £0.5m). The amortisation charge for acquired intangibles was £5.1m (November 2015: £2.3m).

Group adjusted PBT increased by 5% to £16.7m (November 2015: £15.9m).

The adjustments include the transaction costs of the acquisitions of £0.6m and the losses incurred in Domain Services as the winding down process completes. Losses were reduced to £0.2m (November 2015: £1.0m). The remaining assets in Domain Services are the Open Registry group of companies and it is expected that they will be sold by the end of May 2017.

The Group has not seen an impact of the exchange rate on the resale of third party software as the price paid by the Group is passed on directly to clients with a suitable margin.

Forecast for 12 months to 31 May 2017

The outlook for the Group remains positive, especially with the market backdrop of ever-increasing high profile cyber security breaches. A gap has developed in the Assurance division between the Group's expected first half adjusted and actual adjusted EBITDA, which has become too significant to fill in the second half.

After a full Board and management review of the financial forecasts and considering the health of the Assurance business over the longer term, it was decided not to remediate the profit shortfall with short term initiatives.

Accordingly, the Group now expects adjusted EBITDA for the year to 31 May 2017 to be in the range of £45.5m to £47.5m, which will see a growth in the range of up to 5% year on year. The H1:H2 adjusted EBITDA expected split will be approximately 46%:54% at the midpoint of the range.

The Group's total forward order books and renewals as stated at 12 December 2016 is £112.8m, up 4% (September 2016: £108.8m).

The Assurance Division's order book and renewals base is £88.8m (September 2016: £84.2m). Escrow renewals are now forecast to be £21.3m for the current financial year (November 2015: £19.3m).

Forward order books for both Divisions comprise contracted and committed to be delivered, whilst renewals relate to renewing contracts that will be delivered during next 12-month period.

Assurance

At a revenue level the **Assurance** Division continued to perform strongly with a 42% increase in revenue (November 2015: 57%) to £104.8m (November 2015: £73.8m). Excluding the effects of the recent acquisitions, organic growth was 21% (November 2015: 17%). On a constant currency basis, revenue growth would have been 36%.

During the early part of the year as previously announced, the Assurance Division lost three unrelated sizeable contracts that were to be delivered during the financial year. The cancelled contracts were all with existing clients and were not lost to competitors.

One project had been ongoing for over 12 months and came to an immediate stop. The other two were special work that was expected to start in the first quarter and run for almost the full year.

These contracts, like the majority of the Division's work, were made up of a large number of sub projects all of which had been part of the underpinning of the Group's delivery and recruitment schedule throughout the year.

In total, the Group anticipated that these three projects would have delivered approximately £14m to £18m of revenue in the full year. Due to the specialist nature of the work, two of the contracts would have been delivered at a considerably higher margin than for normal consultancy assignments.

The Accumuli business has been fully integrated into the Group since the early part of the year. Most of it forms part of the Managed Security Services unit within the Assurance Division. The business remains a highly profitable component of the Division.

The contract renewals issues, noted in the 20 October 2016 trading update, related to the Accumuli contracts in the Managed Security Services unit. Although not material in scale, they were time consuming and being high margin impacted this unit's contribution.

The Group has made some staffing changes within this part of the business with a view to improving its performance.

As previously stated, the integration of Fox-IT will take place slowly and carefully due to the size and the complexity of the business, with, as stated at the time of acquisition, an expectation that it will not become earnings enhancing before 2018.

The high assurance unit within Fox-IT creates, designs, develops, manufactures and implements secure communication products, using advanced cryptology. It is technically very advanced and highly confidential, as well as being difficult to plan for as the contracts are lumpy by their nature.

One of the largest customers of the high assurance unit is the Dutch Government. As anticipated, the Group is in complex and sensitive negotiations with that government about the wider Group's engagement given the highly confidential nature of so much of this unit's work.

The impact of these discussions has seen work being deferred but on completion it is expected that future opportunities will come to fruition.

The rest of the Fox-IT business, which is approximately 65% of its revenues in the first half of the year, is already starting to see the benefits of mutual cooperation and opportunities in new markets for appropriate Fox-IT products and services.

Escrow

The **Escrow Division** continued to perform strongly. Revenue grew by 14% (November 2015: 7%) to £18.7m (November 2015: £16.4m). On a constant currency basis, revenue growth would have been 8%.

Group Escrow termination rates continue to be around 11%. The global verification order book continues to be solid, with good prospects. It now stands at £2.8m (September 2016: £3.6m).

In the **UK,** revenue as expected, grew by 6% (November 2015: 7%) which reflects a good performance against an exceptionally strong performance last year.

In **North America,** revenue grew sharply by 43% (November 2015: 10%) and in mainland **Europe**, the smallest part of the Escrow Division, revenue grew by 19% (November 2015: 3%). On a constant currency basis, the growth for the combined overseas entities was 12%.

Acquisitions

The Group's acquisition strategy remains to acquire boutique security consultancies that provide either a geographic, service or client fit with the Group. These will continue to be acquired by way of a profit based, earnings enhancing, earn out based deferred cash consideration model.

The Group acquired Boston based PSC on 28 September 2016 for a maximum consideration after completion adjustments of $20.4m (£15.6m) in cash and VSR on 10 November 2016 for maximum consideration after completion adjustments of $5.4m (£4.2m) in cash.

Future acquisitions will most likely be in North America where there is sufficient resource and capability to integrate them in to our existing business structure.

All the Group's acquisitions, except the latest two small acquisitions and Fox-IT, are fully integrated in to the Group.

Balance sheet

The Group's **net debt** decreased at 30 November 2016, as expected, to £48.8m (November 2015: £73.1m) against a total debt facility of £112.5m which comprises £80m revolving credit facility, £27.5m term loan and £5m overdraft.

The Group continues to be highly cash generative with the ratio of operating cash flow before interest and tax being 104% of operating profits (November 2015: 116%) after adjusting for exceptional items.

In H1, the Group has spent: $20.3m (£15.7m) on the initial consideration for the purchase of PSC and VSR; DKK17.6m (£2.0m) on deferred consideration to Fort Consult for completing its earn out in full; €12.5m (£10.6m) to Fox-IT relating to their deferred payment schedule; and approximately £4.0m in capital expenditure which relates to buildings and IT equipment. The Group chose not to issue €2.5m (£2.1m) of new shares as part of the deferred payment to Fox-IT as had originally been intended.

The Group's working capital requirements have changed as the mix of business has changed as the bias moves more towards Assurance. This was accentuated most by the acquisitions of Accumuli and Fox-IT and to a lesser extent by PSC and VSR.

Combined with the organic growth within the Group's businesses, these acquisitions have caused the amount of accrued income to grow. Consultant's salaries, the Group's main costs, are incurred in advance of their chargeable time being invoiced to clients, accordingly the value of trade and other receivables has increased ahead of trade and other payables.

Trade and other receivables were £77.3m (November 2015: £57.8m) at the half year, a 34% increase on the prior year. This trend will continue as the Group grows organically and by acquisition, although to date the age profile of the Group's trade and other receivables has not changed. Trade and other payables are £31.9m (November 2015: £34.0m).

In accordance with IAS38, the Group capitalises the software development of internal systems or products that are being delivered to the market, such as performance tools, portals and platforms. These tools are commercially developed for use on, and sale to, clients in the Assurance division.

In the first half of the year the Group has capitalised direct costs of £4.3m (November 2015: £4.3m). This has remained level reflecting the change in the business due to the additions of Accumuli and Fox-IT and the curtailment of Domain Services, where the rate of capitalisation has substantially fallen.

Summary

The Board believes that despite this short-term setback, NCC Group is very well positioned to capitalise from the positive market economic conditions and is confident of delivering in line with its revised expectations.

The Group expects to report its half-year results, for the six months to 30 November 2016 on Thursday, 19 January 2017.