18 July 2017

# NCC Group plc

NCC Group plc (LSE: NCC, “NCC” or "the Group"), the independent global cyber security and risk mitigation expert, has reported its full year results for the 12 months to 31 May 2017 and provides an update on the Strategic Review.

**Year end results**

- Group revenue up 17% to £244.5m (2016: £209.1m), organic growth 3% excluding impact of FX and acquisitions
- Operating loss £53.4m (2016: profit £11.4m)
- Adjusted* EBIT £27.5m (2016: £39.7m)
- Individually significant charges of £71.0m, including intangible asset write downs of £62.0m
- Adjusted* EBITDA £36.2m (2016: £45.0m), in line with revised expectations
- Adjusted* basic earnings per share 6.7p (2016: 11.8p)
- Basic loss per share 20.4p (2016: earnings 2.5p)
- Net debt reduced to £43.7m from half year level of £48.8m
- Total dividend maintained at 4.65p per share with final dividend of 3.15p per share
- Completed two small US based bolt-ons
- Significant changes to the Board

**Strategic Review**

- Markets and customer views of NCC services continue to be positive
- NCC scores highly against the most important key customer purchasing criteria
- Escrow remains an attractive business and stabilises the Group
- Assurance focus on cyber security
    - Web Performance and Software Testing businesses to be sold
- Business needs better internal organisation - changes to operating model underway

**Chris Stone**, Executive Chairman, comments:

***“Our strategic review has identified the business's unique opportunity - leading positions in growing global markets, customers who value us and our exceptionally skilled workforce. But, we need to change how we organise ourselves and improve our internal business processes.***

***“The last financial year was very challenging, with the business performance falling well short of original expectations, as well as outgrowing some of our business processes and controls.***

***“However, and more importantly, it is clear that the business has a number of notable strengths. We still enjoy significant organic growth in our core segments and have a strong balance sheet. Furthermore, in a constantly evolving and complex market, our unique skills and capabilities are recognised by our customers as putting us at the forefront of the market.***

***“When we have successfully managed our way through this transitional period, improved our organisation and how we go to market, we see significant upside opportunities and material value creation.***

***“Overall, the Board’s expectations for adjusted EBIT in 2018 are unchanged with its confidence in our prospects reflected in the recommendation to maintain the dividend at the current level.”***

* This is a non-GAAP or Alternative Performance Measure (APM). Adjusted figures exclude the amortisation of acquired intangibles, individually significant items, share-based charges, the unwinding of discount on deferred and contingent consideration, the results of the exited Domain Services business and any associated tax thereon.

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# Executive chairman's statement

## Overview

NCC has a unique opportunity: we hold leading positions in growing markets around the world, our customer's value us, and our workforce is exceptionally skilled. However, we need to change how we organise ourselves and improve our internal business processes. This will enable us to capture significant additional value.

My first statement to shareholders as Executive Chairman reflects on two strong but contradictory themes. Firstly, the past year has been very challenging, both operationally and financially. Business performance has fallen short of expectations, we have outgrown some of our business processes and controls, and we have experienced significant changes to our Board.

Equally, and more importantly, it is already clear that the years ahead present significant upside opportunities. Strong value creation will result if we effectively implement our new strategy and successfully manage NCC through the transitional period in which we now find ourselves.

Our business is not broken – indeed it has some notable strengths, both financial and operational. We still enjoy significant organic growth in our core markets and have a strong balance sheet. Furthermore, in a constantly evolving and complex market, our unique market leading skills and capabilities are keeping us at the forefront of thought leadership. This is recognised by customers, who reward us with high levels of repeat business. If we improve our organisation and how we go to market, we will also see material value creation.

## Business Performance

The financial performance for the year was clearly disappointing though in line with revised expectations. Despite delivering revenue growth of almost £35.4m (up17%), Adjusted* EBIT went backwards to £27.5m from £39.7m in the prior year. Operating profit fell from £11.4m in the prior year to a loss of £53.4m. This outcome reflected a number of historical weaknesses in our operating model.

## Strategic Review and Strategic Plan

Following the trading update on 21 February 2017, the Board commissioned a Strategic Review. The Review focused on three key areas. Firstly, to develop a better understanding of our market place, our competitors and our customers. Secondly, to assess the relative strengths and weaknesses of NCC in the market. Thirdly, to assess the value created by the current portfolio of businesses.

The review confirmed that our markets remain attractive, and more importantly, that customers regard NCC as a strong competitor in these markets with a clearly differentiated proposition.

The cyber security theme (or 'golden thread') that runs through the Assurance Division represents a unique set of competencies and capabilities that we can leverage to deliver greater customer value in a highly complex and fragmented market. Our sector and application specific product offerings are leading edge and our solutions capabilities are valued and sought after.

The Review also confirmed the current financial logic of the relationship between Assurance and Escrow. Escrow itself is an attractive business and provides a stabilising influence on the Group.

Finally, the Review identified two of the smaller Assurance businesses that sit outside the cyber golden thread whose future would be better served under alternative ownership. These businesses, Web Performance and Software Testing, will be disposed of in due course.

Subsequently we initiated the development of a new Strategic Plan and revised Target Operating Model in order to underpin our ‘go to market’ and delivery strategies. In the next 12 to 24 months, we intend to focus more of our efforts on internal self-help measures than has historically been the case.

This should ensure that we reverse the margin compression seen in both trading divisions and most territories in the last two years. The Group will then benefit from further organic growth with foundations built on scalable products and business processes. These new foundations will also enhance our ability to leverage acquisition related growth when the Group returns to being acquisitive. Acquisition activity is therefore likely to be limited during this period to smaller ‘bolt-ons’.

## Dividends

The Board has reviewed business performance in the current year alongside our historical progressive dividend policy. While mindful of the need for investment over the next few years, the Board is confident in our prospects and hence recommends that the dividend is maintained at the current level.

A final dividend of 3.15p is therefore being recommended by the Board, making a total for the year of 4.65p, equal to the prior year. If approved, the final dividend in respect of the year ended 31 May 2017 will be paid on 29 September 2017 to shareholders on the register as at 1 September 2017 with an ex-dividend date of 31 August 2017.

As a matter of note, an administrative non-compliance issue has been identified with respect to distributable reserves and the payment of historical dividends. At all times the Group had adequate reserves in subsidiary companies to meet these dividends. We expect to remedy the position by means of a shareholder circular and appropriate resolutions at the AGM in September.

## Current trading and outlook

All businesses go through transitional phases as they grow and mature. NCC is no exception. Where we are different, and at a significant advantage to many, is that change has not been forced upon us by mounting losses, a stretched balance sheet, technological obsolescence or a sudden shrinkage in our markets.

We are operating in a rapidly growing international market in which our core skills and competencies allow us to lead rather than follow. Our challenge is to manage the transition from one business model to another, as the growth in scale and complexity has made our early stage model ineffective. We now need to create structures and products that allow us to benefit from our scale and deliver additional value for our customers whilst never losing sight of our core competencies and strengths, most notably represented in our staff, their energy and their commitment.

So while there is a lot of work to do to implement new processes, systems and structures, the outlook for NCC remains very positive. In fast growing international markets, with a range of innovative products and services, the challenge is to execute effectively the planned changes in strategy and operating model.

The Board is confident that the Group can deliver sustainable earnings growth and enhanced shareholder value once it has more robust foundations in place. We are not only ‘securing tomorrow, today,’ for our customers, but for all of our long term stakeholders.

In terms of trading for the current financial year, the Board expects Escrow to return to low single digit revenue growth and see some margin improvement. The Assurance business is expected to see high single digit revenue growth as we build from the low point of the second half of last year. Assurance gross margins will improve as we implement our new operating model over the course of the new financial year. Set against these gains in gross profit are some cost headwinds arising from higher overheads linked to property costs and the amortisation and depreciation increases that result from capital spend in 2017. Finally, the disposal of the Web and Software Testing businesses will reduce EBIT on a pro rata basis by £2.7m based on 2017 results.

Overall the Group’s expectations for adjusted EBIT in 2018 are unchanged.

## Governance

During the year, the Board has undertaken a major review of some of the Group's governance structures. In part, this was prompted by a combination of shareholder and employee feedback. In addition, there was also the realisation that rapid growth in recent years had taken the Group beyond the design limits of the previous operating model.

The Board remains committed to high standards of corporate governance. We are working actively to enhance governance as well as our business processes and internal controls to match our ambitions for the Group's future. The results of the Governance Review will are set out in the Annual Report and Accounts

## Board composition

There have been a number of changes to the Board during the year. I joined the Board on 6 April 2017 as a Non-Executive Director, becoming Executive Chairman in April when Paul Mitchell stood down as Chairman.

Last year we noted our intention to strengthen the team further with an additional independent Non-Executive Director. As a result, Jonathan Brooks joined the Board as a Non-Executive Director on 13 March 2017. Jonathan brings significant valuable experience of the technology sector.

Brian Tenner was appointed as Chief Financial Officer on 1 February 2017 following a search process prompted by the resignation of, Atul Patel, on 10 August 2016. He became Interim CEO on 1 March 2017, following the decision of Rob Cotton to step down as CEO.

The current model of an Executive Chairman working closely with Brian as Interim CEO and CFO has been a necessary and effective bridge to deliver the Strategic Review and also maintain stability in the management of the business. Recognising that this is not a sustainable long term solution, the Board has commenced a process to identify a permanent CEO using a firm of independent executive search consultants.

## Board effectiveness

As Executive Chairman, I am responsible for the leadership of the Board and ensuring its effectiveness in all aspects of its performance. During the year, the Board has reviewed its performance and effectiveness in accordance with the requirements of the Code. We note that the recent and significant changes in membership and new strategic direction represent a transition period for the Board as well as the Group.

The Board will work to enhance oversight of the Group's strategic development, monitoring the delivery of its business objectives and the development of the new Target Operating Model. We will also work hard to ensure that we maintain an effective corporate governance framework that keeps pace with the rate of growth and change inside and outside NCC.

## Employees

Our staff are the foundation for the value inherent in NCC. In developing and implementing our new Strategic Plan and Target Operating Model we will work to ensure that we create a working environment that values the individual and allows each one of us to contribute to our full potential. This will include creating organisational values and clearer structures, roles and responsibilities. The coming financial year will also see a greater focus on personal development and training.

I would like to record my own and the Board's sincere thanks to all of the Group's employees who have maintained their focus on delivering excellent service to our customers. This has been achieved against a backdrop of uncertainty caused by the Group's volatile financial and share price performance, particularly in the latter quarters of the year. Our business is entirely reliant on the skills and experience of our staff. We are fortunate to have them choose to build their careers with NCC, and I look forward to working with all of them as we take our business forward.

# Strategic Review

The Group began a Strategic Review in February 2017. The objectives of the review fell into three broad categories:

- Assessing our market place and customers buying preferences and criteria
- Customer and market views of NCC and our capabilities, strengths and weaknesses
- Assessing the commercial and portfolio logic of the current business lines within the Group

As findings emerged from the initial scope of work in the Strategic Review, we began a parallel work stream to consider:

- How we currently organise ourselves to address and capture the opportunities presented in our markets by best leveraging our strengths and unique selling propositions

## Key Findings from the Strategic Review

The key findings from the Strategic Review are set out in more detail below but can be summarised as follows:

**Market place:** our markets continue to grow at or around a double digit rate. Companies buying decisions are more about technical expertise and value for money than a simple price basis.

**Our customers:** NCC scores well on the issues that matter to customers. Technical expertise, value for money and speed of delivery. The quality of customer service does appear to be an issue for the industry generally and NCC is similar in this regard. Our customers want to buy more from us and value our brand and reputation for excellence.

**Our portfolio:** The two divisions of Escrow and Assurance see little cross over in customer purchasing. However, Escrow is a robust stabilising influence on the Group. Within Assurance, we have identified two service lines that would have a better opportunity to flourish under alternative ownership and these will be sold in due course.

As we digested the emerging outputs from the Strategic Review it became clear that to reach our full potential we would need to re-organise how we go to market and how we do business (in terms of our internal processes and structures). We have therefore started work on developing and implementing a new Target Operating Model (TOM).

## The market opportunity

### Introduction

Fundamentally, NCC is operating in a dynamic and fast growing market. Or rather, a series of related but separate fast growing markets. These statements apply whether one considers the market place from a product and service perspective, from a geographical perspective, or from an industry vertical perspective. Change is literally the one constant in almost all aspects of the market.

Today, cybercrime is one of the single biggest threats to businesses and individuals around the world. We estimate that the average cost to recover from a DDoS attack is £275,000 and more than 90% of businesses have experienced some form of cyber security threat. On average, it takes almost 120 days for an organisation to find out that it has been compromised.

Furthermore, from our own research into the safety of the Internet, almost two-thirds of consumers believe an online data breach will compromise their financial information within the next year. The fact that some 60% of consumers are more worried than ever before about protecting their personal and financial information online reinforces the threat as the greatest to face business today.

Online security still seems to be behind the curve in failing to keep pace with the numerous types of organisations and individuals that seek to disrupt the internet and organisations use of systems and data.

The threat of being hacked or having valuable data stolen continues to evolve at a seemingly unstoppable pace. Attacks using phishing, fake payment requests and ransomware are now every day events. These attacks often cause significant operational disruption whose economic consequences can vastly outweigh any cost of remediation or prevention.

Our challenge is to ensure that customers understand that a relatively modest upfront investment in advice or other cyber services can ultimately save significant sums in remediation costs and arising from reputational damage.

The world in which we live cannot be made completely safe from cybercrime. As the number and range of threats proliferate, being innovative and using our experience and skills to protect against attacks becomes more important than ever. NCC is doing this by providing the best security consultants to our clients as well as conducting world-renowned security research.

## Market dynamics

The relevant sub-segments that NCC's core cyber offering competes in are shown below:

| SIZE $BN* | MARKET SEGMENT | NCC OFFERING | |
|---|---|---|---|
| **7.0** | Fully outsourced IT Security | NCC PROVIDES LIMITED SERVICES IN THIS SEGMENT | THREAT INTELLIGENCE |
| **11.0** | Managed Security Services | MONITORING | |
| **6.0** | Advisory, Governance & Assessment | PROCESS & GOVERNANCE | |
| **4.0** | Forensic & Legal Response | SECURITY TESTING | |
| **10.0** | Operational | SECURITY TESTING | |

**OC&C estimates*

The addressable market is clearly large at $38.0 bn in total but very fragmented. Management estimate that NCC is one of the largest 'pure play' cyber security companies focussing on services as opposed to products but that we currently have relatively low market shares in most segments and geographies. Once we have developed robust and scalable internal structures and processes, this will represent a significant opportunity to grow the business profitably though bolt-on acquisitions.

Market research as part of the Strategic Review also confirmed that market growth is likely to continue and that customers' propensity to pay more for high quality advice and solutions is growing.

## Customers buying behaviours and key purchasing criteria (KPC's)

Customers made clear that their key buying criteria focus more on quality of technical expertise and advice as opposed to price. While value for money (effectively a ratio or a comparison of quality and cost) is very important, that reflects more on the demand for quality than low cost.

Interestingly, customers did not place as high a value on the ability to source internationally. Even in those customers who did buy in multiple territories.

- **Technical Expertise**

  Consistently noted as having top-tier technical talent, Fox-IT seen as most technically advanced player in NL

- **Customer Service**

  UK and US customers often feel NCC too transactional, Fox-IT customers value their trusted partnership

- **Value for Money**

  NCC and Fox-IT generally perceived as good value, customers very willing to pay more for quality

- **Speed of Delivery**

  Seen as "mid-sized" competing with boutique pure-plays, NCC advantages include wider capabilities and flexibility

- **Brand / Reputation**

Well known by security professionals in the UK and US, Fox-IT highly regarded in NL (Dutch government work)

- **Low Price**
  Seen to be expensive but price rarely the deciding factor, NCC rated highly as good ‘value for money’

In summary, on the items that matter most to customers in their buying decisions, NCC score well or very well with the exception of customer service which appears to be an industry wide issue.

## Our competitive position

We must continue to drive innovation and thought leadership in our key market segments. The key is to ensure that our thought leadership also leads to practical new solutions to apply to the challenges and issues that our customers face. Finding the right balance of ‘blue sky’ thinking and ideas that can be rapidly commercialised.

Innovation and creativity are two key foundations for the Group’s continued development and growth. Our new Target Operating Model is designed to ensure that these remain a core feature of the business.

The recent well publicised cyber-attacks on a wide range of public and private enterprises around the world are a reminder of the need to constantly innovate.

Our aim is to shift the current range and scale of the services and products offered by NCC in the cyber security market to more repeat business of a highly differentiated nature.

During the Strategic Review we assessed the Group’s ‘Net Promotor Score’ (NPS). This metric is widely used across a range of industries where customer satisfaction is a critical performance indicator. What NPS measures, quite simply, is whether or not a customer, on the basis of its experiences with a service provider, would recommend that service provider to another organisation.

The measurement scale in NPS is itself a challenge – a positive score is counted if it rates a nine or ten out of ten. Conversely, a negative score is recorded for any outcome ranging from zero to six. What this means is that if a company received 100 scores of its service, with 10 ratings in each category, its NPS score would be negative 40.

The results of the NPS survey confirmed NCC with a score of “positive 26”. As noted above in the explanation of the methodology, achieving any sort of positive score is difficult and a positive score of plus 26 means the significant majority of ratings by customers had to be above six out of ten and with a high proportion of those scoring the top two marks.

What the survey did show was that NCC scored better than many of its direct competitors in the Big Four or in the pure play cyber services companies. It is clear, when combined with direct feedback from customers that NCC is well regarded for our technical expertise and our ability to help our customers overcome their cyber security challenges.

## Target Operating Model

Our current organisational structures and operating model have reached the limits of their design tolerances. In many cases the overlay of our business processes on those organisational design features creates a ‘spaghetti wiring diagram’ that is complex, creates unclear accountabilities and is inefficient at delivering business processes and services to customers.

The recent addition of some relatively large acquisitions has emphasised further the need for a clear and transparent operating model that delivers a number of key objectives, the principle ones being as set out below.

**TOM Objective 1: Align the business to how our customers want to buy**
The Strategic Review revealed that even our global customers tend to want to buy local services for delivery in country. This is true even for customers who have a central technology input to sourcing decisions.

This finding drives the conclusion of a TOM that has a primary dimension of geographical business units and P&L accountability.

**TOM Objective 2: Leverage NCC's value between business units**
The business has historically operated within silos. This has been the case even inside individual business units where our structures have not encouraged service or product line leaders to cross sell or provide fully integrated solutions to our customers.

Our historical Go-To-Market model was identified by customers as being too transactional in many cases. While initiatives to address this issue began during the year, the old operating model barriers to collaboration were not removed.

Our customers value our technical expertise and the wide range of services that we offer. Therefore, in order to leverage value across the geographies and service lines, we concluded that a matrix structure would be appropriate for the TOM.

Therefore, the secondary dimension of the TOM is based around key service and product lines with key leadership and accountability roles identified within each to ensure sharing of best practice. To avoid unnecessary cost increases or duplication of roles, there will be some 'double-hatting' in smaller businesses as they grow.

**TOM Objective 3: Deliver an integrated Go-To-Market proposition**
Our customers value our expertise and range of services. They would like to buy more from us. But our current Go-To-Market approach can make this difficult. The challenges flow from disparate accountabilities and targets for different teams within the business units.

We are therefore creating aligned sales and delivery teams with single leaders within each geography. Critically, sales leadership for strategic accounts, transactional sales activities, inside sales, bid preparation and management, and supporting marketing activities will report to one person in each territory. This will allow us to join up our offerings at a more strategic purchasing level within customers while also ensuring that our current successful transactional sales generation machine continues to perform.

**TOM Objective 4: Create scalable structures that facilitate profitable growth**
Our historical ways of working and focus on certain services and products prevent benefits of scale from being realised. Selling more of a particular service would lead to an equal and proportionate increase in our costs and hence no positive operational leverage to drive improving margins.

Our staff management and work allocation processes have been less efficient than we would like. This has led to under-selling of key technical skills in that they are used on activities that attract a lower day rate than they should.

As well as a more accurate matching our staff skills to the value of the work being performed for customers, we also intend to increase our focus on platform based sales such as monitoring services and after sales value added services. In particular, these will be driven from our Security Operations Centres in Delft (Fox) and Leeds (MSS) and will include services such as Threat Intelligence, DetACT, Managed Security Services, and our CTMp platform.

**TOM Objective 5: Design and implement effective and efficient business processes that support operating leverage**
Over the last few years our support costs have been rising steadily, creating a further erosion of operating leverage or in some cases even leading to negative operating leverage. This reflects the fact that in many cases our business processes and systems have not been upgraded to keep pace with the size and complexity of the group.

The Group has been slow in rolling out its preferred core systems and this has caused undue delays, cost increases and inefficiency in how we work. These issues extend from finance and reporting systems to CRM systems to work and staff planning and management processes and beyond.

A key part of implementing the TOM is to embed effective and efficient business processes and systems within it. Over the next two years, we will therefore be focussing on designing and implementing standardised business processes and making sure they and the underpinning systems are rolled out across all of our business units. These systems and processes will often be designed and monitored centrally to ensure shared disciplines and effective control of the business.

Underpinning all of the objectives for the TOM will be a series of direct and specific key performance indicators and other metrics that drive the desired behaviours and outcomes. For example, we will be focussing on realisation for our consultants' time as opposed to the more simple but less informative utilisation measure.

Realisation will focus on a combination of hours worked but also, critically, on the amount of work that is actually billed and the rate at which it is billed. These are currently areas where we believe there is value leakage from the Group and plugging these leaks will help to generate improved margins in future.

## Our strategy

Our new Strategic Plan is designed to deliver more sustainable revenue growth at improved margins, increases in shareholder value, and an improved service and product offering to customers.

We are developing a new set of KPIs that align more closely to our strategic priorities. Some of these are still under development as noted below. We will report on each one as we implement our strategy.

| Strategic Priorities | Rationale and current status | KPIs and our performance in 2017 | Focus and goals for 2018 |
|---|---|---|---|
| 1 Grow<br>At a managed pace and in areas of core strength | In attractive and growing markets where NCC enjoy strong competitive differentiators, we aim to deliver medium term growth in excess of market rates. By focusing on higher value added services we will avoid growth for its own sake while simultaneously protecting our margins. | **Underlying* organic* revenue growth**<br>**2017: 4% (2016: 19%)**<br>Stripping out the impact of acquisitions and changes in foreign currency exchange rates, we aim to deliver growth in the short term broadly in line with market rates. | Implement new Go-To-Market strategy and team structures<br>Growth may therefore lag behind the market during the year<br>Develop a clearer understanding of our pipeline and ordering processes |
| 2 Implement<br>Our new Target Operating Model | The Strategic Review identified that we do not organise ourselves in a way that brings simplicity and efficiency to our service delivery.<br>We will implement a new and clear operating model that delivers better customer service at an improving gross margin. | **Adjusted* gross margin to improve**<br>**2017: 34.7% (2016:38.5%)**<br>Measured as a percentage of gross margin to annual revenue. Gross margin being revenue less direct costs of sales and service delivery.<br>This will be one measure that shows the effectiveness and efficiency of our new TOM | Implement the organisation design concepts in the TOM<br>Develop role descriptions for named management posts<br>Implement a staff appraisal system |
| 3 Improve<br>Business processes and systems | Our existing business processes are inefficient and in many cases difficult to scale. They often rely on manual activity and disparate information systems that can lead to a lack of clarity in decision making.<br>We will design and implement improved business processes with reduced manual interventions to lower in our costs to serve. | **SG&A* ratio to improve**<br>**2017: 23.4% (2016: 19.0%)**<br>General Administration costs as a percentage of annual revenue.<br><br>This KPI reflects the efficiency of our business processes and our 'cost to serve'. | Focus on implementing new processes and systems roll out<br>Expect benefits to flow in the following year<br>Operational leverage gains driven by more basic cost control |

| | | | |
|---|---|---|---|
| 4 Lead Technical thinking and product development In a rapidly evolving and dynamic market sector | The market is evolving so quickly that we need to be at the forefront of developing new services and responses to address emerging threats. Our customers' needs are also changing: not just in response to new threats but also in respect of how and where they carry out their businesses. We need to respond to those changes in how we position ourselves and our services. | Engagement with thought leadership content across all mediums and resulting inbound activity. | Continued demonstration that NCC has a holistic view of cyber security<br>Understanding of opportunities and risk associated with emerging technologies<br>Brand growth with non-traditional audiences |
| 5 Develop our people to allow them to reach their full potential and contribute fully to NCC | All of our key strategic goals will rely fundamentally on our people and their skills. So we need to ensure that we attract and retain high quality staff. We need to ensure they are properly trained, gain the right experiences and are also properly incentivised – by recognition and the working environment as much as by reward. | **Employee turnover 21.8%**<br>Employee engagement survey data from June 2017 will be used to develop some additional appropriate KPIs here. | We will develop and implement employee performance appraisal and development systems |

## Interim chief executive's review

### Group revenue

For the financial year ended 31 May 2017, the Group increased reported revenue by 17% to £244.5m (2016: £209.1m). Excluding Domain Services business that was exited during the year, the growth was £37.7m or 18%.

The table below shows the elements of growth that were organic (net sales growth in businesses that were owned for equivalent periods in the current and prior year), acquisitions growth (includes the full year impact of prior year acquisitions), and growth resulting from the impact of FX rates. Growth from changes in FX rates is calculated by re-stating the prior year revenue figures at current year weighted average rates.

| Growth driver (excluding Domain) | **2017 £m** | **2017 % growth** |
|---|---|---|
| Organic | 6.8 | 3% |
| Acquisition | 21.1 | 10% |
| FX | 9.8 | 5% |
| **Total growth** | **37.7** | **18%** |

The Group's current information systems do not report the impact of foreign exchange movements as a matter of course. The figures above are therefore calculated at year end using assumed weighted average exchange rates for each relevant currency for each year in question. This is being addressed in the Group's new consolidation system which is being implemented in the first quarter of the new financial year.

The FX growth above is driven by increases in the weighted average exchange rates of both the US$ and €uro against £GBP, both of which strengthened by around 15%.

The geographical breakdown of revenue by the location of the delivering business for the current and past year is as follows (Domain excluded):

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| UK | 147.1 | 61% | 144.4 | 71% |

| | | | | |
|---|---|---|---|---|
| US | 58.4 | 24% | 39.2 | 19% |
| Europe and RoW | 36.4 | 15% | 20.6 | 10% |
| **Total revenue** | **241.9** | **100%** | **204.2** | **100%** |

Note: some businesses sell a modest amount of services in other countries and report that revenue as being within their own geography.

The amount of Group revenue earned outside the UK increased by £35.0m and reflects the impact of the Fox-IT acquisition in the Netherlands half way through the last financial year and also strong growth in our US Assurance business.

Both of these factors occurred within the Assurance division where the share of Group revenue has now risen to 85% (2016: 83%).

Underlying organic revenue growth in the first half of the financial year was 19% but in the second half fell by 5% compared to the prior year periods. The second half of the current year actually saw revenue fall compared to the first half, contrary to the historical trends the business has delivered.

Weakness in the second half compared to the prior year and the first half of the current year was particularly focussed in MSS third party product sales which were £6.5m down in the second half compared to the first half.

Fox High Assurance product sales were also down £1.2m in the second half. Between them these reductions accounted for 85% of the fall in sales between the first and second halves.

A more detailed breakdown of the revenue performance in each of the Operating Segments is shown in the Assurance and Escrow divisional reports.

The Group is currently reviewing the basis on which revenue analysis is further reported. This review will include concepts such as recurring revenues, contracted revenues and repeat business. The Group may need to implement systems changes to accurately capture this analysis across all business units. Some further analysis is set out in the Divisional reviews.

The Group continued to have minimal reliance on any one customer or sector. Within Assurance the largest customer represents approximately 4% of Assurance revenue. The largest customer in Escrow is just over 1% of total Escrow revenue.

## Group profitability and margins

The Board and Executive management use a number of non-GAAP measures in their day to day management of the business. The Group's primary financial profitability measure will be Adjusted EBIT. Last year the Group used Adjusted EBITDA for this purpose. It is management's view that Adjusted EBIT is more closely aligned to the underlying performance of the business. The majority of our peers and stakeholders use this metric, and hence it is therefore a more appropriate KPI for use in the business and in our external communications.

The table below sets out the reconciliation between reported statutory measures and the non-GAAP measures of Adjusted EBIT and Adjusted EBITDA.

| | **2017 £m** | 2016 £m |
|---|---|---|
| **Reported operating (loss) / profit** | **(53.4)** | 11.4 |
| Results of Domain Services (exited) | (1.0) | 1.4 |
| Individually significant items (details below) | 71.0 | 18.9 |
| Amortisation of acquired intangible assets | 10.3 | 6.8 |
| Share based payments | 0.6 | 1.2 |
| **Adjusted EBIT** | **27.5** | 39.7 |
| Depreciation | 5.2 | 3.7 |
| Amortisation of software and capitalised development costs | 3.5 | 1.6 |
| **Adjusted EBITDA** | **36.2** | 45.0 |

During the year, despite delivering growth in most of our business units, each business unit and the Group as a whole has seen a contraction in our margins. The main cause relates to cost increasing both before and at a faster rate than the growth in our revenues in each business unit.

Margins contracted due to increases in both direct and indirect costs. Salary related costs represent approximately 70% of the Group's cost base. Cost increases were largely driven by a significant increase in headcount (16%) combined with average salary increases of 6-7% to give total salary based cost increases of approximately 23% or around 16% of sales.

This compares with total organic and acquisition based revenue growth of 15% and led to consequent reduction in utilisation and realisation from our professional service delivery staff.

We also made investments in new sales structures that have not yet born fruit in proportionately increased revenues. Other indirect cost increases reflect £3.4m of additional depreciation and amortization of tangible and intangible assets linked to a number of systems having entered service and hence have started amortizing. In addition there was a £1.3m of acquisition impact on these costs.

Premises costs increased by £1.4m partly to accommodate extra staff and also in upgrading facilities. Marketing spend rose £1.3m as the Group sought to raise its profile in a number of areas.

As a result, Adjusted EBIT in the year fell from £39.7m to £27.5m despite the benefit of a positive foreign exchange impact of £0.6m. At the same time, our Adjusted EBIT margin fell from 19.4% to 11.4%.

The Group's overall EBIT result included £0.2m of losses from the now closed Domain Services operating segment (2016: operating losses £1.4m). The current year charge was then offset by a £1.2m profit on disposal of Open Registry (also treated as an adjusting item).

The Group's reported pre-tax loss was £55.3m (2016: profit £9.4m).

## Assurance Division – Business Performance Review

### Assurance revenue

Assurance now accounts for 85% of Group revenue and the impact of foreign exchange rate changes contributed £8.0m to the growth in the division.

In addition, Assurance benefitted from the full year effect of the prior year acquisition of Fox-IT (impact in 2017: £14.0m) and acquisitions in the year just completed (PSC £5.9m and VSR £1.1m).

Net organic growth was £6.8m which represented year on year growth of 5.0% with the balance due to changes in foreign exchange rates (£8.0m impact).

The table below shows the revenue split between Security Consulting and a combined Web Performance and Software Testing.

| | **31 May 2017 £m** | 31 May 2016 £m | Change % |
|---|---|---|---|
| **Assurance revenue** | | | |
| Security Consulting | 178.1 | 138.9 | 28% |
| Software Testing and Web Performance | 26.6 | 30.0 | (11%) |
| **Total** | **204.7** | **168.9** | **21%** |

Revenues in our Web Performance and Software Testing businesses fell by £0.5m (5%) and £2.9m (14%) respectively. In Web Performance, we felt the impact of a slower take up than expected for a new service line an have taken an impairment charge on this business.

In Software Testing the loss of a project that was already underway at the start of the year, following a strategic decision to cancel a divestment by the customer, had a negative impact on both revenue and costs as utilisation rates for permanent staff fell.

Towards the end of the financial year, both Web Performance and Software Testing businesses saw a pick up in sales pipeline opportunities and also in some longer term contract wins.

The table above can act as a guide to the impact on revenue of the proposed disposals of the Web Performance and Software Testing businesses during the course of the new financial year ending 31 May 2018. Neither business is particularly seasonal and therefore any reduction to the Group total turnover following the disposals is likely to be pro rated to the point in the new year when the businesses are sold.

The Assurance division saw very mixed revenue results during the year. While the headline growth rate for the Security Consulting activities is very attractive, some business lines saw better performance than others.

The underlying performance of the Security Consulting business lines is much easier to understand using constant currency and also by splitting performance between organic and acquisition based growth.

Assurance revenue is broken down into more detail in the table below in terms of the impact of changes in foreign exchange rate, the impact of acquisitions in both the prior year and the year under review, and the organic performance of a number of operating units within Security Consulting:

| **Assurance revenue bridge** | **Growth £m** | **£m** | **Growth %** |
|---|---|---|---|
| Revenue for the year ended 31 May 2016 | | 168.9 | |
| Impact of FX changes | 8.0 | | |
| Full year of owning Fox-IT | 14.0 | | |
| PSC acquisition this year | 5.9 | | |
| VSR acquisition this year | 1.1 | | |
| **Net revenue growth from FX and acquisitions** | | **29.0** | **17%** |
| UK Consulting organic growth | 11.0 | | 19% |
| US Consulting organic growth | 5.3 | | 24% |
| Fox-IT – excluding High Assurance | 1.6 | | 17% |
| Fox-IT – High Assurance | (3.6) | | (53%) |
| MSS – excluding product sales | 2.8 | | 17% |
| MSS – product sales | (7.4) | | (48%) |
| Other including Web and Software Testing | (2.9) | | |
| **Net organic growth** | | **6.8** | **5%** |
| | | | |
| **Total Assurance revenue growth** | | **35.8** | **21%** |
| **Revenue for the year ended 31 May 2017** | | **204.7** | |

The table above highlights the number and variety of moving parts in explaining this year's revenue performance. The impact of changes in FX rates and acquisitions is shown in the top half of the table.

For the purposes of this analysis, given that Fox-IT was acquired at the end of November 2015, the whole of the first half of the current financial year's revenue has been attributed to the impact of the acquisition.

Growth in UK and US consulting revenues were very healthy, representing growth of 19% and 24% respectively on a constant currency basis. This was driven by a combination of market growth and our ability to capture share due to our scale. In addition, we have been bringing new products to market and continuing to expand our focus areas beyond transactional activity.

Within Fox-IT we saw two strong opposing forces. As previously announced, a key customer for Fox High Assurance products (Fox-HA) significantly slowed down its purchases from the business following the change in ownership of the company.

It is clear that we should have engaged with this customer in a transparent way ahead of the acquisition to allay some of their concerns. However, we have since been working hard and collaboratively to allay the concerns of the customer and we are starting to see some new orders coming in for Fox-HA products from this critical customer.

If momentum is maintained we should see some growth in this service line in the new financial year compared to the year ending 31 May 2017.

In sharp contrast, to Fox-HA, the other Fox service lines saw organic growth of 17% in the second half of the year compared to the same period of ownership in the prior year. In particular, our CTMp platform and Threat Intelligence made promising progress.

This is particularly pleasing in that both of these are key service lines that we aim to expand within the Netherlands and then to leverage in other NCC locations.

The scalability of the CTMp platform will also support margin recovery. It is for this reason and the emerging recovery in Fox-HA, that while the execution challenges for the business are reflected in the impairment of around 30% of the goodwill associated with the acquisition, we remain confident about the prospects for the Fox-IT business and its capability to support a broader platform of scalable high value add services across the NCC.

In MSS we also saw two conflicting but slightly different themes from those in Fox IT. The negative force there has been in the re-sale of third party products which fell by £7.4m compared to the prior year, equating to a fall of 48% and a fall in 2017 second half sales of products of almost 90% to £0.7m.

The fall partly reflects the end of an earn-out period that had been put in place when the business was acquired by the previous owners and subsequently extended by NCC. In addition, we are trying to change our focus to higher value add activities and the building of long term relationships with our customers.

We have not pursued these sorts of sales as strongly as in previous years. Instead, where we continue to sell third party products, we will aim to link those purchases to implementation consulting advice and after sales services such as monitoring in our Leeds based Security Operations Centre (SOC).

While the revenue would have helped the year's results, we are not overly concerned as we seek to deliberately re-balance the business away from single transaction re-selling of third party products.

Similarly to Fox-IT, the areas of the business where we do see longer term value and growth potential, the service lines grew by 17% year on year.

The summary of the Assurance revenue is:

- good growth was delivered in those areas where we want to place our future focus as this is where scalable margin recovery can be created
- Fox-HA will start to recover in the coming year
- Re-selling third party products in MSS in the medium term will be continued if we can create linkages to our own value added after sales services
- Acquisitions and FX also played strong supporting roles in the revenue growth story.

The table below is an estimated split of our Assurance revenue streams based on currently available information. We will be improving the quality and granularity as well as the relevance of our internal management information systems over the coming years. The data therefore gives a broad indication of the split of our revenue streams.

| | 2017 | | 2016 | |
|---|---|---|---|---|
| **Assurance revenue type** | **£m** | **% of total** | **£m** | **% of total** |
| Consulting services | 156.1 | 76% | 122.4 | 73% |
| Managed Services | 24.9 | 12% | 11.8 | 7% |
| Product sales | 23.8 | 12% | 34.7 | 20% |
| **Total** | **204.7** | **100%** | **168.9** | **100%** |

Product sales are a mix of third party products and our own. Currently we are not able to perform the same analysis at a gross margin or profitability level.

**Assurance profitability analysis**

While revenue grew in total by £35.8m (21%), the absolute level of adjusted operating profit fell year on year by £9.2m (35%). The fall in operating profit is all the more stark because it is after the positive impact of foreign exchange gains of £0.4m and the benefit of acquisitions. The acquisition benefits were from a full year of ownership of the Fox-IT (£0.5m) and part year ownership of PSC and VSR (£1.7m).

Adjusted EBIT margins fell to 8.2% (2016: 15.3%). The more significant driver for this was the increase in overall salary costs.

Our consulting businesses in the UK and US both saw a fall in absolute profitability as a lack of control over the cost base meant that it grew faster than our revenue streams. In particular this reflected a strategy to build sales and delivery teams ahead of equivalent revenue growth and that led to margins being compressed in both businesses at a Gross Margin and EBIT margin level.

At the same time, the Group was starting to develop its strategic sales capability to allow us to move further up our customers internal purchasing decision chains to become less transactional and more strategic in approach. That investment has been slower than anticipated to bear fruit.

The Assurance business will typically see one or two major unplanned contract wins in any particular year. These can be related to the reaction to a major event at a customer or a specific proactive project such as corporate activity.

In the year to May 2017, the division did not have a material benefit from any such contracts and actually suffered from the loss of some. In one specific case, a large scale Software Testing project (reference above) was already underway with staff deployed on the ground. When the customer discontinued the contract the revenue stream stopped very quickly in the first half whereas it had been expected to run for most of the year.

A second large scale project was cancelled before it began. In the third, which had not become a contracted order but had been a firm prospect as NCC were the preferred supplier for that type of work, the customer decided not to proceed with the work.

The estimated potential revenue from the three contracts was around £14-17m and £6-7m of gross margin (based on a gross margin assumption of 40%). Approximately £7-10m of this revenue had been included in the Group's operating plan at the start of the year.

The most challenged part of the Assurance division was MSS which saw a fall in revenue of £4.6m (14%). As noted earlier, while much of the revenue fall related to less attractive sales of third party products, the gross margin delivered would still have been a helpful contribution towards the overhead base.

Similarly to the consulting businesses, in MSS the Group set about re-balancing the sales efforts and teams towards strategic and higher value added sales of customer solutions comprising product, professional services and managed services. While we are confident that this is the correct approach in the medium term, the short term impact was to increase our cost base at a time when revenues were falling.

There was also the impact of ongoing integration challenges for the MSS service lines (acquired under the Accumuli plc transaction).

## Escrow Division Business Performance Review

### Revenue performance

The Escrow division now accounts for 15% of Group revenues (2016: 17%). Escrow revenue for the year grew by £1.8m (5%) to £37.1m (2016: £35.3m). Excluding the impact of FX, at constant currency rates underlying growth was £0.1m (0.3%).

| | **31 May 2017 £m** | 31 May 2016 £m | % Change |
|---|---|---|---|
| Revenue | | | |
| UK | 25.4 | 25.7 | (1%) |
| USA | 7.9 | 6.2 | 27% |
| Europe | 3.9 | 3.4 | 13% |
| **Total Escrow revenue** | **37.2** | **35.3** | **5%** |

**Escrow UK**
Escrow UK revenue was £25.4m (2016: £25.7m).

During the second half of the year we identified that some invoices had been recognised as revenue ahead of the related service delivery. The correction of this issue reduced reported revenue in the year by £1.0m with an almost equivalent EBIT impact.

The issue had built up over three years and no individual year required a material adjustment and hence the full impact was recognised as a one off, non-recurring, non-cash item in the current year. While there was never any question of not delivering the service and in many cases payment was received in advance, this revised approach is deemed to be a more appropriate application of the Group's unchanged policy on revenue recognition.

The reported 1% reduction in revenue (2016: 8% growth) would have been growth of 3% if not for the one-off adjustment.

Escrow UK recurring revenues increased to £14.1m (2016: £13.7m) and terminations remain around 11% with nearly 90% of all contracts renewed (2016: 90%).

We expect UK growth to remain modest given the relative market maturity and our market share.

**Escrow USA**
Escrow US revenues grew by 27% to £7.9m (2016: £6.2m) with recurring revenues of £4.5m. Approximately half of this related to the impact of changes in FX rates with the balance all being organic growth.

In the fourth quarter we re-structured our senior management and sales team in Escrow USA to build further on the significant opportunity we have in that country.

**Escrow Europe**
Escrow Europe revenues grew by 13% to £3.9m (2016: £3.4m) with recurring revenues of £2.1m. However, all of this and more was the result of changes in FX rates. On an underlying organic basis the business actually shrank by 3%.

This reflects significant management change in our European Escrow team that are being addressed in the first half of the new financial year.

**Escrow Rest of the World**
The division has recently established an office in Dubai to take advantage of the Group's reputation and expertise in a region that has good demand potential for Escrow services and in which we have a number of existing clients, allowing us to build a larger footprint in anticipation of Expo 2020.

Our short term goals for the Escrow division as a whole are:

- to maintain our market leading position in the UK, delivering modest annual organic growth
- to continue to develop evolving solutions for customers in a SaaS and Cloud based world
- to build on our scalable capability in the US
- to stabilise our relatively small footholds in a number of European territories (the Netherlands, Germany, and Switzerland).
- to begin to build out from our new positions in our 'Rest of the World' offices in Dubai and Singapore.

Escrow UK now has 111 employees (2016: 107), Escrow Europe has12 employees (2016: 15) and the North American Escrow businesses have 41 employees (2016: 59).

Escrow revenues and growth can be further analysed as follows:

| | **2017** | 2016 | Change |
|---|---|---|---|
| | **£m** | £m | % |
| **Reported revenue** | | | |
| Escrow contracts | 26.3 | 24.6 | 7% |
| Verification testing | 9.6 | 9.7 | (1%) |
| Other services | 1.3 | 1.0 | 30% |
| **Total Escrow revenue** | **37.2** | **35.3** | **5%** |

**Escrow profitability analysis**

The table below shows the split of EBIT by Escrow region. For reporting purposes, RoW EBIT is included within the UK.

| | **31 May 2017 £m** | 31 May 2016 £m | Change % |
|---|---|---|---|
| **EBIT** | | | |
| UK | 17.4 | 18.3 | (5%) |
| USA | 3.7 | 3.0 | 23% |
| Europe | 1.9 | 2.0 | (5%) |
| Shared central costs | (3.9) | (3.2) | (22%) |
| **Total Escrow adjusted* EBIT** | **19.1** | **20.1** | **(5.0%)** |

The £1.0m impact on profitability of the revenue recognition issue has been noted above. Because the revised approach was adopted in the second half of the financial year but applied to the year as a whole, it has had a disproportionate impact on the reported results in the second half. Excluding this adjustment, EBIT for Escrow would have been flat year on year.

The division experienced some of the same increases in the cost base as seen in the Assurance division but to a lesser degree. As a result, EBIT margins in the division fell by 5.6% to 51.3% (2016: 56.9%) with revenue recognition being a one off 2.6% reduction.

The revised operating model that is already in place for the Escrow teams around the world mean that the division should deliver an improvement in margins in the new financial year ending May 2018.

## Individually significant items

The carrying value of all of our goodwill and intangible assets were assessed as part of our normal year end process. As a result, there have been a number of impairments recognised in respect of good will and other intangible assets.

The Fox and former Accumuli businesses (the latter now known as MSS) have underperformed in the year compared to our original acquisition forecasts. They have also encountered integration challenges that have slowed the pace of commercial leverage of the different new service and product lines across the rest of the Group.

In MSS we are also shifting focus away from one part of the business that previously concentrated on simply re-selling third party products often without value added after sales services.

The net result of these factors is to recognise an impairment of the goodwill that arose on the acquisition of Accumuli plc by £24.3m. This equates to around 50% of the goodwill attributable to what is now known as MSS. It is worth noting that one part of the Accumuli business has been successfully and fully integrated with our UK Security Consulting business and its share of goodwill (£14.3m) is now considered as part of that Cash Generating Unit (CGU).

In Fox we have recognised an impairment of £24.3m of goodwill, representing around 30% of the goodwill that arose on acquisition.

While we are confident that the Fox IT business and service lines and the MSS business re-focused on value added managed services and advisory services are attractive business in the medium to long term, there is much to be done to realise this potential. The length of time needed to realise this potential and the execution risks involved over that period mean that it is appropriate to recognise the impairment of these assets.

In our Web Performance business we have reviewed the carrying value of both internally generated intangible assets and the goodwill associated with the acquisition of that business. While we do see longer term value in this business, some of the revenue generating intangible assets have been slower than originally anticipated to generate revenues and a retained customer base.

The slower ramp up in revenue has therefore led to the recognition of impairments over two assets amounting to £3.2m and over goodwill of £5.7m.

In the prior year it was announced that the Group was withdrawing from the Domain Services operating segment. At that time two assets were retained with carrying values of £2.5m and £2.0m in respect of the .trust TLD and a software application for use in Domain and potentially in other retained parts of the Group.

Given the inherent uncertainties in realising any value from the .trust TLD, it has been decided to write that asset off in full. The Group will seek to maximise any value from the asset. It has now been identified that the retained Domain software system does not have a role in the business going forward and it too has been fully impaired.

Other individually significant items in the year are set out in the notes below. They include:

- Adjustments to deferred and contingent consideration due to changes in FX rates £2.9m;
- Holiday pay accrual relating to previous financial periods of £1.8m;
- Restructuring costs of £1.3m relate to professional fees for the Strategic Review, the Target Operating Model project, exit payments to the former CEO, and retention bonuses paid to former employees of Accumuli plc;
- Double running and exit costs of £1.3m for empty properties;
- Impairment of property plant and equipment (£0.9m) on the planned re-location of the Group's Manchester Head Office in September 2017; and
- Acquisition costs £0.8m.

Prior year individually significant items are set out in Note 3

## Taxation

The Group's adjusted effective tax rate is 29.3% (2016: 22%), which is above the average standard UK rate of 20% (2016: 21%). The higher effective rate reflects the higher tax rates incurred in the overseas businesses. It had been reported in January 2017 that the tax rate for the year would rise to around 31%.

This was based on an estimated position at the time of the Interim Results in January 2017 and included certain assumptions about the level and geographical origin of pre-tax profits.

The actual results were lower than those estimates and a significant part of the reduction was the level of profit arising in higher tax territories. The Group expects to maintain the effective P&L tax rate at around 30% for the next few years, assuming a similar geographic split of profitability compared to the current year.

The Group has recently hired a tax and treasury manager whose role will include developing a longer term strategy for tax and treasury matters. In both of these areas the Board has a low risk appetite to purse aggressive tax strategies and the new strategies will operate inside that.

## Earnings per share

The adjusted basic earnings per share from operations was 6.7p (2016: 11.8p).

The table below reconciles basic EPS to Adjusted EPS on the Group's definitions of adjusting items including their tax impact.

| | **2017 Pence** | 2016 Pence |
|---|---|---|
| Basic EPS as per the income statement | (20.4) | 2.5 |
| Domain exit | (0.6) | 0.4 |
| Amortisation of acquired intangibles | 2.7 | 2.1 |
| Individually significant items | 24.8 | 6.2 |
| Share based payments | 0.1 | 0.4 |
| Unwinding discount on deferred consideration | 0.1 | 0.2 |

| | | |
|---|---|---|
| **Adjusted basic EPS** | **6.7** | **11.8** |

The adjusted fully diluted earnings per share from continuing operations was 6.7p (2016: 11.2p) whilst reported fully diluted loss per share was 20.4p (2016: earnings 2.4p).

### Dividends

The Board is recommending a final dividend of 3.15p per ordinary share, making a total for the year of 4.65p. This represents a dividend equal to that paid in the prior year.

While dividend cover is negative (2016: 2.4 times based on basic adjusted earnings per share from continuing operations), the Board is confident that the Group's new Strategic Plan will be a source of long term sustainable growth in earnings, cash flow and shareholder value.

An administrative non-compliance issue has been identified with respect to distributable reserves and the payment of previous dividends. We expect to remedy the position by means of a shareholder circular and appropriate resolutions at the AGM in September 2017.

## Cash

We will transparently disclose the key moving parts in our cash flows. As part of this, we are adopting a new definition and calculation of Free Cash Flow and Cash Conversion ratio that is more closely aligned to market practice.

The table below summarises the Group's cash flow for the year.

| | **2017 £m** | 2016 £m |
|---|---|---|
| Cash inflow before changes in working capital | 33.8 | 37.3 |
| Changes in working capital | (2.1) | (14.2) |
| Interest paid | (1.9) | (2.0) |
| Income taxes paid | (1.8) | (7.3) |
| **Net cash from operating activities** | **28.0** | **13.8** |
| Net capital expenditure | (10.6) | (11.6) |
| Capitalised development costs | (3.7) | (1.9) |
| **Free cash flow** | **13.7** | **0.3** |
| Acquisitions | (26.6) | (76.7) |
| Disposals | 0.1 | - |
| Dividends | (12.8) | (10.3) |
| Share issues | 0.7 | 123.7 |
| **Net cash flow before financing** | **(24.9)** | **37.0** |
| | | |
| Opening net debt | (12.7) | (50.6) |
| Foreign exchange impacts | (6.1) | 0.9 |
| **Closing net debt** | **(43.7)** | **(12.7)** |

The Group generated a net £28.0m of cash from operating activities. This is before deducting £3.7m of internally capitalised development costs.

Working capital saw a reduction in accrued income as our billing processes became more effective and timely in the fourth quarter. While the natural consequence of this is then an increase in trade debtors, the net impact is to shorten the working capital lifecycle and accelerate cash conversion. The net working capital cash outflow was the result of deliberate management action to improve supplier relations by improving the profile of creditor payments compared to prior years.

Significant opportunities to improve working capital remain. For example, unbilled accrued income over 60 days old amounts to £2.7m and £9.7m of similarly aged trade debtors represent an opportunity to improve.

Interest and tax cash costs remained modest and the latter reflects in part the lower profitability of our overseas higher tax rate territories.

Net capital expenditure of £11.0m was a mix of discretionary and maintenance capex. No breakdown of discretionary versus maintenance capex is available as yet. However, maintenance spend includes costs of new hardware and software for use in the business. Discretionary spend includes a number of new office locations that have either been acquired or moved into in the year ending 31 May 2017.

The largest one off 'discretionary' capex spend in 2017 was the £3.8m cost of Category A and B fit out costs of the Group's new headquarters building in Manchester that will be occupied in the summer of 2017.

The move was occasioned by the end of the existing lease and the need for more space to accommodate business growth. The fit out costs in the year were almost fully funded by a landlord contribution of £3.7m. The estimate to complete the project is £4.4m and the final cash costs will be paid in the 2018 financial year.

We expect property, plant and equipment capex to be at a similar level in the 2018 financial year. The expected reduction from one-off property costs incurred in 2017 will be compensated by the remaining costs of the Manchester head office capex. In 2019, after the property projects have been completed, we expect capex to reduce by £3-4m.

Conversely, we expect our annual premises costs which include depreciation, rent, and rates to increase in the new financial year by £1.9m which will be an annualised £2.2m in the following year.

The calculation of the cash conversion ratio for the last two years is set out below and referenced to the various notes in the Annual Report.

| | **2017**<br>**£m** | 2016<br>£m |
|---|---|---|
| Net cash generated from operating activities | 28.0 | 13.8 |
| Adjusted EBITDA | 36.2 | 45.0 |
| **Cash conversion ratio (A) / (B)** | **77%** | 31% |

One of the main drivers for the difference between operating cash flow and EBITDA are the capitalised development cash costs in the year of £3.7m which if charged against EBITDA will give a cash conversion ratio of 86% in 2017.

## Financing facilities

In November 2016, the Group increased its banking facilities to £110m (May 2016: £78m) with a new five year multi bank facility, comprising a £80m (May 2016: £78m) revolving credit facility and a £30m (May 2016: nil) five-year term loan. The term loan amortises at £2.5m every six months until maturity and at the end of the year the term facility stood at £25.0m.

The Group's primary banking covenants are:

- Leverage limit of 2.5 times and this is calculated as Adjusted EBITDA / Net Debt. For the purposes of the covenant test, net debt includes deferred consideration on acquisitions (but not contingent consideration)
- As at 31 May 2017 leverage for banking purposes stood at 1.50 times, comfortably below the Group's maximum 2.5x covenant limit.
- Net Interest cover which is calculated as Adjusted EBITDA / net interest payments and has a limit of 3.5 times.
- As at 31 May 2017 net interest cover was 25.9 times, again comfortably above the minimum level.

At the year end outstanding contingent payments relate to PSC of £2.8m and VSR of £1.3m. The payments to the former owners of PSC and VSR are due in two equal instalments and are measured in December 2017 and December 2018 by reference to profit targets set at the time of the acquisitions.

Also outstanding is non-contingent deferred consideration in respect of the acquisition of Fox IT comprising of €10m in cash and €2.5m shares due to be paid in November 2017. The Group has the option to make the share based payment in cash instead.

### Principal risks and uncertainties

The Group operates in a dynamic and evolving market place. As new events occur or the business transitions into new activities or phases of its development, the risk register is updated accordingly.

For example, reflecting the changing nature of the business, during 2016-17, we had to complete the integration of two new and sizable acquisitions into our risk management processes. As a result of these acquisitions, the Group now has a larger proportion of its revenue coming from hardware or other product sales and also from key strategic customers, with the consequence of there being less predictable sales cycles and in some cases larger but less frequent and less predictable sales.

During the year, we saw a slowing in purchase activity by a key strategic customer in the Netherlands. We also incurred customer losses, while professionalising the contracts management activities in one of the businesses we recently acquired, as well as having to bear increased costs.

Furthermore, as a result of these recent large acquisitions, the scale and complexity of the Group increased and enhanced controls and processes needed to be put in place. In order to address this, the Board approved the appointment of a Director of Risk and Assurance, and a Group Tax and Treasury Manager.

Detailed descriptions of the current principal risks and uncertainties faced by the Group, their potential impact and mitigating processes and controls are set out below. The tables also highlight whether the risk is assessed as increasing or decreasing with a similar assessment for the position last year. This includes identifying new principal risks and uncertainties.

| **Risk Areas** | **Potential Impact** | **Mitigation** |
| --- | --- | --- |
| **1 Strategy**<br>As the Group and its operating environment change, so too must its strategy if it is to continue to succeed and generate increasing shareholder value.<br><br>The Group is in the process of changing and developing a new strategy that will need to take root. | A poor strategy or ineffective execution of a strategy would have a material negative impact on the Group's financial performance and value. It would potentially weaken the Group compared to its competitors and risk the Group's established position in the market place. | Members of the Board have significant experience in evolving business strategies. This experience has been complemented by the use of external consultants who have participated in the recent Strategic Review. |
| **2 Management of change**<br>As the Group adapts and changes its strategy there are a number of complex projects and initiatives that not only need to be delivered but also require understanding and support from all staff | Poor change management could lead to ineffective implementation of projects that then cost more to deliver, take longer to deliver, result in fewer benefits being realised (or all three). | The Board has been enhanced during the last six months by the appointment of an executive Chairman and Interim CEO, both of whom have extensive experience of implementing change on organisations.<br><br>Through regular engagement with all levels of staff the Group will ensure that the Group's Vision and strategy is shared with and understood by all staff. |
| **3 Information Technology**<br>The Group is heavily reliant on continued and uninterrupted access to its IT systems. The Group is a natural target for individuals who may seek to disrupt the Group's commercial activities. | If the Group's systems failed, this could affect the Group's ability to provide services to our customers. If a system failure was the result of a successful external cyber attack, this could result in the loss of sensitive data and compromise the Group's reputation as a leader in the field of cyber security.<br><br>Failing to successfully implement new IT systems could similarly cause business disruption. | The Group has made significant investment in its IT infrastructure to ensure it continues to support the growth of the organisation.<br><br>The Group has appropriate controls in place in order to mitigate the risk of systems failure and data loss, including systems back-up procedures and disaster recovery plans. The Group also deploys appropriate malware protection, network security controls and encryption of mobile devices.<br><br>The Group is currently reviewing high priority systems changes to ensure that projects are well managed and deliver the required targeted benefits in an appropriate timeframe. |

| | | |
|---|---|---|
| **4 Recruitment & retention of key personnel**<br>The Group would be adversely impacted if it were unable to attract and retain the right calibre of skilled staff.<br>Some roles within the Group operate in highly technical and extremely specialised areas in which there are shortages of skilled people. | Loss of key managers could result in a lack of necessary expertise or continuity to execute the Group's strategy.<br>An inability to attract and retain sufficient high-calibre employees could become a barrier to the continued success and growth of NCC | Key personnel are tied in through rewarding career structures and attractive salary packages, which can include participation in share schemes.<br>Succession plans are being finalised for key members of the management team where they are not already in place.<br>The Group is reviewing our assessment and development processes to ensure that our employees can enjoy opportunities for further career training and development. |
| **5 Conduct and reputational risk**<br>Damage can result to our reputation or business by a combination of unanticipated events or by the acts of a single employee | Conduct risk can arise from a number of areas such as failing to meet customer expectations on project delivery, testing assignments or source code handling or from employees who could maliciously disrupt the business and steal customer information.<br>All such instances could result in damage to reputation, loss of repeat business and potentially lead to litigation and/or claims against NCC. | NCC operates a system of policies and procedures which are regularly audited as part of the Quality System.<br>These, combined with management oversight, the risk management process, project reviews and customer feedback, mitigate the risk to successful service and project delivery. All staff are trained regularly and backups are taken wherever possible before testing assignments begin.<br>Employees are vetted before joining and robust controls and processes are in place to manage employees such as accounting controls, IT monitoring large downloads of data and controls on client site operations. |
| **6 Cyber risk**<br>This is the risk that is faced by many of our customers, that external agents will successfully access and harm NCC data and operating systems, inspired by either the pursuit of financial gain or malice. | As a provider of security services, the Group is a high profile target and could therefore be targeted by attacks specifically designed to disrupt the Group's business and harm the Group's reputation. If such an attack was successful, it could adversely affect the market's perception of the Group as well as causing business disruption. | The Board has constituted a Cyber Security Committee chaired by the Senior Non-Executive Director.<br>Security testing is regularly carried out on the Group's infrastructure and there are extensive measures in place to assist in identifying and dealing with security incidents.<br>The Group has a dedicated Information Security Management Forum which meets regularly to discuss security risks to the Group. Employees also receive regular security training and updates. |
| **7 Acquisitions and disposals**<br>Acquisitions and disposals can be costly to complete and complex to deliver the targeted benefits. Risks range from deal execution (including price negotiations, due diligence, and contracting) to transition and integration into (or separation from) NCC | Well-executed acquisitions and disposals with an appropriate purchase price can create significant value. Poorly executed acquisitions and disposals or those with excessive purchase prices can destroy shareholder value. | As part of its medium term strategy, the Board remains committed to making value-enhancing acquisitions.<br>The need to establish a robust and scalable 'Target Operating Model' for the Group, including integrated ways of working, processes and systems, means that the Group is less likely to make any material acquisitions for the next 1 to 2 years while that TOM is put in place.<br>Furthermore, the significant write down in the carrying values of goodwill following the acquisition of Accumuli and Fox-IT has led the Board to commence a review of our acquisition process and |

| | | |
|---|---|---|
| | | disciplines to identify areas for improvement and ways in which to reduce the risk of future impairments on any new acquisitions. This includes developing a more robust post-acquisition integration process to deliver targeted benefits. |
| **8 Competition and failure to respond to market trends**<br>Barriers to market entry are relatively low in some of our lower value service offerings. Equally, in such a dynamic and fast evolving technology space, products or services can be rendered obsolete by new technologies or platforms | A major change in the technology landscape could lead to a decline in an individual service line's revenue stream. One example of a recent change that needs a response is the move to more cloud based applications and data storage. | The Group employs a number of industry leading experts and thought leaders in our market place. This puts us at the forefront of change and allows us early insight into emerging trends. This in turn allows us to anticipate or pre-empt a number of potential risks.<br>Group wide technology and technical forums are used to disseminate and share market intelligence and trends, as well as to formulate responses, on a regular basis. |
| **9 Failure to protect intellectual property**<br>A number of the Group's service offerings depend on intellectual property rights that need to be registered, maintained and protected in various jurisdictions. Examples include trademarks, patents and valuable know-how. | If such rights are not sufficiently protected, the Group could potentially no longer be able to offer a particular service in some or all countries. | Patents are applied for where appropriate and intellectual property is only disclosed under a licence agreement or confidentiality agreement. The Group also takes steps to differentiate its IP as far as possible to lower the risk of any potential infringement claims. |
| **10 Liquidity, foreign exchange and banking facilities**<br>The Group requires access to adequate banking facilities to fund its daily operations, capital investments and potential acquisitions.<br>Furthermore, as the Group's international footprint expands, there is an inherent risk of adverse foreign exchange movements affecting profitability. | Inability to re-finance the Group's core banking facilities could call into doubt the Group's longer-term viability. Equally, if those facilities lacked the appropriate flexibility and structure, this could inhibit delivery of the Group's strategy.<br>The absence of any currency hedging in 2016-17 resulted in an exchange loss of £3.7m | The Group's current banking facilities cover all of its expected needs of the Group for the period of such facilities and are sufficiently flexible to allow the Group to function effectively.<br>The Group has recently appointed a Tax and Treasury Manager for the first time. Part of their role is to support the CFO in developing a Treasury strategy and overseeing its implementation.<br>The Board is currently reviewing a new Foreign Exchange hedging strategy that is primarily based on net cash flow hedging. |

On behalf of the Board

Brian Tenner
Interim Chief Executive
18 July 2017

## Consolidated Income Statement
**for the year ended 31 May 2017**

| | Note | 2017 Total £m | 2017 Adjustments (Note 3) £m | 2017 Adjusted £m | 2016 Total £m | 2016 Adjustments (Note 3) £m | 2016 Adjusted £m |
|---|---|---|---|---|---|---|---|
| **Revenue** | 2, | 244.5 | (2.6) | 241.9 | 209.1 | (4.9) | 204.2 |
| Cost of Sales | | (160.2) | 2.3 | (157.9) | (150.6) | 3.8 | (146.8) |
| Reclassification of costs | 4 | - | - | - | 21.2 | - | 21.2 |
| **Gross profit** | | **84.3** | (0.3) | **84.0** | 79.7 | (1.1) | 78.6 |
| Administration expenses | | (137.7) | 81.2 | (56.5) | (68.3) | 29.4 | (38.9) |
| Administration expenses comprises: | | | | | | | |
| General & administrative expenses | | (57.0) | 0.5 | (56.5) | (41.4) | 2.5 | (38.9) |
| Profit on sale of subsidiary companies | 5 | 1.2 | (1.2) | - | | | |
| Amortisation of acquired intangible assets | 9 | (10.3) | 10.3 | - | (6.8) | 6.8 | - |
| Individually significant items | 3 | (71.0) | 71.0 | | (18.9) | 18.9 | - |
| Share based payments | | (0.6) | 0.6 | - | (1.2) | 1.2 | - |
| **Operating (loss)/profit** | 2,4 | **(53.4)** | 80.9 | **27.5** | 11.4 | 28.3 | 39.7 |
| Net Interest expense | | (1.4) | - | (1.4) | (1.4) | - | (1.4) |
| Discount on acquisition consideration | | (0.5) | 0.5 | - | (0.6) | 0.6 | - |
| **Net financing costs** | | **(1.9)** | 0.5 | **(1.4)** | (2.0) | 0.6 | (1.4) |
| **(Loss)/profit before taxation** | | **(55.3)** | 81.4 | **26.1** | 9.4 | 28.9 | 38.3 |
| Taxation | 6 | (1.3) | (6.3) | (7.6) | (3.1) | (5.2) | (8.3) |
| Attributable to equity holders of the parent company | | **(56.6)** | 75.1 | **18.5** | 6.3 | 23.7 | 30.0 |
| **Earnings per share from continuing operations** | 8 | | | | | | |
| Basic earnings per share | | (20.4p) | | | 2.5p | | |
| Diluted earnings per share | | (20.4)p | | | 2.4p | | |

## Consolidated Statement of comprehensive income
**for the year ended 31 May 2017**

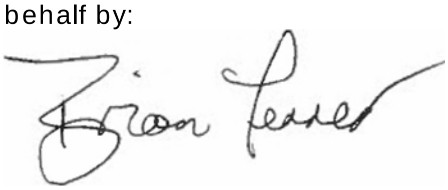
| | 2017 £m | 2016 £'m |
|---|---|---|
| **(Loss)/profit for the year** | (56.6) | 6.3 |
| **Items that may be reclassified subsequently to profit or loss (net of tax)** | | |
| Foreign exchange translation differences | 17.9 | 9.7 |
| **Total comprehensive (loss)/income for the year, net of tax** | (38.7) | 16.0 |
| Attributable to: | | |
| **Equity holders of the parent** | (38.7) | 16.0 |

## Consolidated statement of financial position
**at 31 May 2017**

| | Notes | 2017 £m | 2017 £m | 2016 £m | 2016 £m |
|---|---|---|---|---|---|
| **Non-current assets** | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Intangible assets | 9 | **267.6** | | 297.3 | |
| Plant and equipment | 10 | **18.3** | | 12.7 | |
| Investments | | **0.4** | | 0.6 | |
| Deferred tax assets | 13 | **4.2** | | 5.3 | |
| **Total non-current assets** | | | **290.5** | | 315.9 |
| **Current assets** | | | | | |
| Trade and other receivables | 11 | **66.7** | | 66.4 | |
| Inventories | | **1.1** | | 0.3 | |
| Cash and cash equivalents | | **12.3** | | 20.7 | |
| **Total current assets** | | | **80.1** | | 87.4 |
| **Total assets** | | | **370.6** | | 403.3 |
| **Current Liabilities** | | | | | |
| Trade and other payables | 14 | **29.7** | | 31.6 | |
| Provisions | 14 | **1.5** | | - | |
| Consideration on acquisitions | 14 | **12.9** | | 3.5 | |
| Deferred revenue | 15 | **35.6** | | 36.3 | |
| Current tax payable | | **3.0** | | 1.2 | |
| **Total current liabilities** | | | **82.7** | | **72.6** |
| **Non-current liabilities** | | | | | |
| Deferred tax liability | 13 | **14.2** | | 15.5 | |
| Provisions | 16 | **3.5** | | 0.4 | |
| Consideration on acquisitions | 16 | **2.1** | | 18.5 | |
| Interest bearing loans | | **56.0** | | 33.4 | |
| **Total non-current liabilities** | | | **75.8** | | **67.8** |
| **Net Assets** | | | **212.1** | | 262.9 |
| **Equity** | | | | | |
| Issued capital | | **2.8** | | 2.8 | |
| Share premium | | **148.0** | | 147.3 | |
| Merger reserve | | **42.3** | | 42.3 | |
| Retained earnings | | **(7.1)** | | 62.5 | |
| Reserve for own shares | | **-** | | (0.2) | |
| Currency translation reserve | | **26.1** | | 8.2 | |
| **Total equity attributable to equity holders of the parent** | | | **212.1** | | 262.9 |

These financial statements were approved by the Board of Directors on 18 July 2017 and were signed on its behalf by:



**Brian Tenner**
Interim Chief Executive
NCC Group plc
4627044

## Consolidated statement of cash flows
**for the year ended 31 May 2017**

| | Notes | 2017 | 2016 |
|---|---|---|---|
| | | **£m** | £m |

| | | | |
|---|---|---|---|
| **Cash inflow for the year before changes in working capital** | 17 | **33.8** | 37.3 |
| Increase in trade and other receivables | | **(2.3)** | (15.1) |
| Decrease in trade and other payables | | **0.2** | 0.9 |
| **Cash generated from operating activities before interest and tax** | | **31.7** | 23.1 |
| Interest paid | | **(1.9)** | (2.0) |
| Income taxes paid | | **(1.8)** | (7.3) |
| **Net cash generated from operating activities** | | **28.0** | 13.8 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of plant and equipment | 10 | **(11.0)** | (4.6) |
| Capital contribution for property, plant and equipment | 16 | **3.7** | - |
| Proceeds from disposal of property | | **0.4** | - |
| Software and development expenditure | 9 | **(7.4)** | (8.9) |
| Acquisition of businesses | | **(28.4)** | (78.5) |
| Cash acquired with subsidiaries | 12 | **1.9** | 1.8 |
| Cash disposed of from sale of subsidiaries | 5 | **(1.7)** | - |
| Proceeds from sale of subsidiaries | | **1.7** | - |
| **Net cash generated in investing activities** | | **(40.8)** | (90.2) |
| | | | |
| **Cash flows from financing activities** | | | |
| Purchase of own shares | | **-** | (0.1) |
| Proceeds from the issue of ordinary share capital | | **0.7** | 123.8 |
| Draw down / (repayment) of borrowings | | **18.9** | (33.5) |
| Equity dividends paid | | **(12.8)** | (10.3) |
| **Net cash used in financing activities** | | **6.8** | 79.9 |
| | | | |
| **Net (decrease)/increase in cash and cash equivalents** | 17 | **(6.0)** | 3.5 |
| | | | |
| **Cash and cash equivalents at beginning of year** | | **20.7** | 16.4 |
| Effect of foreign currency exchange rate changes | | **(2.4)** | 0.8 |
| **Cash and cash equivalents at end of year** | | **12.3** | 20.7 |

**Reconciliation of net change in cash and cash equivalents to movement in net debt**

| | **2017** | 2016 |
|---|---|---|
| | **£m** | £m |
| (Decrease)/increase in cash and cash equivalents | **(6.0)** | 3.5 |
| Change in net debt resulting from cashflows | **(18.9)** | 33.5 |
| Foreign currency translation differences on cash and cash equivalents | **(2.4)** | 0.8 |
| Foreign currency translation differences on borrowings | **(3.7)** | 0.1 |
| **Change in net debt during the year** | **(31.0)** | 37.9 |
| **Net debt at start of year** | **(12.7)** | (50.6) |
| **Net debt at end of year** | **(43.7)** | (12.7) |

| **Net debt comprises** | **2017** | 2016 |
|---|---|---|
| | **£m** | £m |
| Cash and cash equivalents | **12.3** | 20.7 |
| Total borrowings (Note 21) | **(56.0)** | (33.4) |
| **Net debt** | **(43.7)** | (12.7) |

## Statements of changes of equity
### for the year ended 31 May 2017

### Group

| | Issued Share capital £m | Share Premium £m | Merger Reserve £m | Currency Translation reserve £m | Reserve for own shares £m | Retained Earnings £m | Total £m |
|---|---|---|---|---|---|---|---|

| | Issued Share capital £m | Share Premium £m | Merger Reserve £m | Currency Translation reserve £m | Reserve for own shares £m | Retained Earnings £m | **Total** £m |
|---|---|---|---|---|---|---|---|
| **Balance at 1 June 2015** | 2.3 | 24.0 | 42.3 | (1.5) | (0.5) | 65.1 | 131.7 |
| Profit for the year | - | - | - | - | - | 6.3 | 6.3 |
| Adjustment to currency translation reserve from sale of subsidiary companies | - | - | - | 0.1 | - | - | 0.1 |
| Foreign currency translation differences | - | - | - | 9.6 | - | - | 9.6 |
| **Total comprehensive income for the year** | **-** | **-** | **-** | **9.7** | **-** | **6.3** | **16.0** |
| **Transactions with owners recorded directly in equity** | | | | | | | |
| Dividends to equity shareholders | - | - | - | - | - | (10.3) | (10.3) |
| Share based payment transactions | - | - | - | - | - | 1.1 | 1.1 |
| Current and deferred tax on share based payments | - | - | - | - | - | 0.6 | 0.6 |
| Shares issued | 0.5 | 123.3 | - | - | - | - | 123.8 |
| Purchase of own shares | - | - | - | - | 0.3 | (0.3) | - |
| **Total contributions by and distributions to owners** | 0.5 | 123.3 | - | - | 0.3 | (8.9) | 115.2 |
| **Balance at 31 May 2016** | **2.8** | **147.3** | **42.3** | **8.2** | **(0.2)** | **62.5** | **262.9** |

| | Issued Share capital £m | Share Premium £m | Merger Reserve £m | Currency Translation reserve £m | Reserve for own shares £m | Retained Earnings £m | **Total** £m |
|---|---|---|---|---|---|---|---|
| **Balance at 1 June 2016** | 2.8 | 147.3 | 42.3 | 8.2 | (0.2) | 62.5 | 262.9 |
| Profit for the year | - | - | - | - | - | (56.6) | (56.6) |
| Foreign currency translation differences | - | - | - | 17.9 | - | - | 17.9 |
| **Total comprehensive income for the year** | - | - | - | 17.9 | - | (56.6) | (38.7) |
| **Transactions with owners recorded directly in equity** | | | | | | | |
| Dividends to equity shareholders | - | - | - | - | - | (12.8) | (12.8) |
| Share based payment transactions | - | - | - | - | - | 0.2 | 0.2 |
| Current and deferred tax on share based payments | - | - | - | - | - | (0.4) | (0.4) |
| Shares issued | - | 0.7 | - | - | - | - | 0.7 |
| Purchase of own shares | - | - | - | - | 0.2 | - | 0.2 |
| **Total contributions by and distributions to owners** | - | 0.7 | - | - | 0.2 | (13.0) | (12.1) |
| **Balance at 31 May 2017** | **2.8** | **148.0** | **42.3** | **26.1** | **-** | **(7.1)** | **212.1** |

# Notes

**(forming part of the financial statements)**

## 1 Accounting policies

### Basis of preparation

NCC Group plc ("the Company") is a company incorporated in the UK. The Group financial statements consolidate those of the Company and its subsidiaries (together referred to as the "Group"). The parent company financial statements present information about the Company as a separate entity and not about the Group.

These financial statements have been approved for issue by the Board of Directors on 18 July 2017.

The financial information set out herein does not constitute the Company's statutory financial statements for the year ended 31 May 2017 or the year ended 31 May 2016 but is derived from those financial statements. Statutory financial statements for 2016 have been delivered to the Registrar of Companies, and those for 2017 will be delivered in due course. The auditors have reported on those statutory financial statements; their report was (i) unqualified, (ii) did not include references to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain statements under sections 498(2) or 498(3) of the Companies Act 2006.

In accordance with EU law (IAS Regulation EC 1606/2002), the group financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') adopted for use in the EU as at 31 May 2017 ('adopted IFRS'), International Financial Reporting Interpretations Committee ('IFRIC') interpretations and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The preliminary results consolidate those of the Company and its subsidiaries.

The Group financial information has been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted for use within the European Union and in accordance with the accounting policies included in the Annual Report for the year ended 31 May 2016. A number of new standards and amendments to existing standards were effective for the financial year ended 31 May 2017. None of these have had a material impact. A number of standards, amendments and interpretations have been issued and endorsed by the EU, but which are not yet effective and accordingly the Group has not yet adopted. The cumulative impact of the adoption of these standards is not expected to significant.

**Basis of measurement**

The consolidated financial statements have been prepared on the historical cost basis except for consideration payable on acquisitions that is measured at fair value.

**Functional and presentation currency**

The Group and Company financial statements are presented in millions of Pounds Sterling (£m) and all values are rounded to one decimal place except when otherwise indicated.

**Going concern**

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Business and Financial.

The Group funds its strategic acquisitions and meets its day to day working capital requirements via a multi-currency revolving credit facility of £80.0m, a £25.0m multi-currency term loan that amortises by £2.5m every six months and an overdraft of £5m. At 31 May 2017, the amount drawn down under the facilities was £56.0m. This facility was agreed in November 2015 and is due for renewal in November 2020.

The Directors have reviewed the trading and cash flow forecasts of the Group as part of their going concern assessment and have taken into account reasonable downside sensitivities which reflect uncertainties in the current operating environment. The possible changes in trading performance show that the Group is able to operate within the level of the banking facilities and as a consequence, the Directors believe that the Group is well placed to manage its business risks successfully. After making enquiries, the Directors have a reasonable expectation that the company and the Group have adequate resources to continue in operational existence for a period of at least twelve months. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

## 2 Segmental information

The Group is organised into the following two reporting segments (2016: three) Escrow and Assurance each of which is separately reported. While revenue and profitability are monitored by individual business units within these operational segments it is only at the operating segment level that resource allocation decisions are made. Performance is measured based on segment profit, which comprises segment operating profit excluding amortisation of intangible assets, share based payment charges and exceptional items. Interest and tax are not allocated to business segments and there are no intra-segment sales.

**Segmental analysis 2017**

| | Escrow | Assurance | Domain | Head Office | Group |
|---|---|---|---|---|---|

| | £m | £m | £m | £m | £m |
|---|---|---|---|---|---|
| Revenue | 37.2 | 204.7 | 2.6 | - | 244.5 |
| Cost of sales | (2.0) | (155.9) | (2.3) | - | (160.2) |
| Gross profit | 35.2 | 48.8 | 0.3 | - | 84.3 |
| G&A before Adjustments | (17.1) | (104.4) | (4.5) | (11.7) | (137.7) |
| **Operating profit** | **18.1** | **(55.6)** | **(4.2)** | **(11.7)** | **(53.4)** |
| Adjustments* | 1.0 | 72.2 | 4.2 | 3.5 | 80.9 |
| **Adjusted operating profit** | **19.1** | **16.6** | **-** | **(8.2)** | **27.5** |
| Depreciation of PP&E | 0.2 | 2.9 | - | 2.1 | 5.2 |
| Amortisation of software and capitalised development costs | - | 1.7 | - | 1.8 | 3.5 |
| **Adjusted EBITDA** | **19.3** | **21.2** | **-** | **(4.3)** | **36.2** |

*Adjustments includes the results of Domain Services, individually significant items and other adjustments (Note 3).

### Segmental analysis 2016

| | Escrow | Assurance | Domain | Head Office | Group |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| Revenue | 35.3 | 168.9 | 4.9 | - | 209.1 |
| Cost of sales | (1.7) | (123.9) | (3.8) | - | (129.4) |
| Gross profit | 33.6 | 45.0 | 1.1 | - | 79.7 |
| G&A before Adjustments | (14.4) | (30.7) | (17.2) | (6.0) | (68.3) |
| **Operating profit** | **19.2** | **14.3** | **(16.1)** | **(6.0)** | **11.4** |
| Adjustments* | 0.9 | 11.5 | 15.6 | 0.3 | 28.3 |
| **Adjusted operating profit** | 20.1 | 25.8 | (0.5) | (5.7) | 39.7 |
| Depreciation of PP&E | 0.2 | 2.0 | - | 1.5 | 3.7 |
| Amortisation of software and capitalised development costs | - | 0.7 | - | 0.9 | 1.6 |
| **Adjusted EBITDA** | **20.3** | **28.5** | **(0.5)** | **(3.3)** | **45.0** |

The revenue classified as adjustments relates to Domain services (Note 6).

There are no customer contracts which account for more than 10% of segment revenue.

| | **2017** | 2016 |
|---|---|---|
| | **£m** | £m |
| **Revenue by geographical destination** | | |
| UK | **140.1** | 122.2 |
| Rest of Europe | **37.5** | 34.1 |
| Rest of the World | **66.9** | 52.8 |
| **Total revenue** | **244.5** | 209.1 |

## 3 Individually significant items

Individually significant items and other adjustments have been presented in a separate column in the consolidated income statement to provide users of the accounts with a reconciliation to the Group's separately reported non-GAAP results.

The Group separately identifies items as "individually significant items". As permitted by IAS1 'Presentation of financial statements', an item is disclosed separately if it is considered unusual by its nature or scale, and is of such significance that separate disclosure is required to fairly present the financial performance of the Group.

| **Adjustments** | **2017** | **2016** |
|---|---|---|
| | **£m** | **£m** |

| | | |
|---|---|---|
| Domain results (Note 5) | **0.2** | 1.4 |
| Profit on sale of subsidiary companies (Note 5) | **(1.2)** | - |
| Amortisation of acquired intangible assets (Note 9) | **10.3** | 6.8 |
| Individually significant items (see below) | **71.0** | 18.9 |
| Share based payments | **0.6** | 1.2 |
| Discount on acquisition consideration | **0.5** | 0.6 |
| **Adjustment to loss before taxation** | **81.4** | 28.9 |

The revenue, cost of sales and general and administrative expenses in the current and prior year relate to Domain services. The prior year treatment of the Domain trading loss has been amended to be consistent with the current year treatment as an adjusting item in calculating non-GAAP measures. The profit on sale of subsidiary companies relates to the disposal of the Open Registry Group in January 2017 for a net profit £1.2m (Note 5).

| **Individually significant items** | **2017 £m** | **2016 £m** |
|---|---|---|
| Goodwill impairment: | | |
| • Fox-IT | **(24.3)** | - |
| • Accumuli | **(24.3)** | - |
| • Web Performance | **(5.7)** | - |
| • Open Registry | **-** | (11.9) |
| Intangible asset impairment: | | |
| • Capitalised development costs | **(5.7)** | (6.8) |
| • Software costs | **(2.0)** | - |
| **Impairment of intangible assets** | **(62.0)** | (18.7) |
| Acquisition related costs | **(0.8)** | (2.3) |
| Adjustments to consideration | **(2.9)** | 4.7 |
| Restructuring costs | **(1.3)** | (2.6) |
| Onerous property leases | **(1.3)** | - |
| Vacation pay | **(1.8)** | - |
| Impairment of fixtures and fittings | **(0.9)** | - |
| **Other** | **(9.0)** | (0.2) |
| **Total - individually significant items** | **(71.0)** | (18.9) |

Acquisition related costs of £0.8m (2016: £2.3m) consist of fees incurred in relation to the acquisitions of Payment Software Company Inc on 28 September 2016 and Virtual Security Research LLC on 11 November 2016 (note 12). In the prior period, the costs relate to fees incurred in relation to the acquisition of Fox-IT Holdings BV.

The adjustment to consideration of a £2.9m charge relates to foreign exchange revaluation differences on the carrying value of consideration in the prior year of £4.7m income relate to the net gains related to the re-assessment of the Open Registry contingent consideration and an adjustment to the consideration payable for a previous Accumuli plc acquisition.

A goodwill impairment of £54.3m (2016: £11.9m) has been recognised in respect of the CGU's for Fox-IT Holdings BV, Accumuli plc and Web Performance (Note 9). The underlying drivers for these impairments are discussed in more detail in the performance review sections of the Strategic Report.

The directors have assessed the carrying value of intangible assets and concluded that the carrying values of certain capitalised development and software costs are impaired (Note 11). Accordingly, a write down of £5.7m (2016: £6.8m) has been recognised in respect of capitalised development costs (£3.2m) and in respect of the *.trust* domain name (£2.5m). In addition, residual Domain Services software with a book value of £2.0m has been written off in full. In the prior year, the intangible asset write down of £6.8m relates to the impairment of capitalised costs for redundant technology.

The group has incurred restructuring costs of £1.3m (2016: £2.6m) relating to the exit payments to the former Chief Executive (as shown in the Remuneration Report) and other members of senior management. In addition, professional fees in relation to the Strategic Review and retention bonuses paid to former employees of Accumuli plc were also incurred. As previously reported NCC became responsible for paying these bonuses on acquisition of the Accumuli group. In the year to 31 May 2016, restructuring costs included Accumuli plc retention bonuses, severance costs and other costs associated with the wind down of the Domain Services division.

The onerous property lease charge of £1.3m (2016: £nil) is in respect of double running costs of empty properties. The £1.8m charge for vacation pay relates to previous financial periods and this is described in more detail in the Audit Committee Report. Of the total charge, £0.5m relates to the prior year with the balance relating to prior years up to 31 May 2015 with no significant charge in any one year. The £0.9m (2016: £nil) impairment of fixtures and fittings relates to items in the current head office which will be obsolete after the relocation later this year.

The tax effect in the income statement relating to the individually significant items recognised is:

| | **2017 £m** | 2016 £m |
|---|---|---|
| Goodwill impairment (breakdown shown below): | | |
| • Fox-IT | **-** | - |
| • Accumuli | **-** | - |
| • Web Performance | **-** | - |
| • Open Registry | **-** | - |
| Intangible asset impairment (breakdown shown below): | | |
| • Capitalised development costs | **(1.4)** | (2.3) |
| • Domain name | **-** | - |
| **Impairment of intangible assets** | **(1.4)** | (2.3) |
| Acquisition related costs | **(0.3)** | (0.2) |
| Adjustments to deferred and contingent consideration | **0.1** | |
| Restructuring costs | **(0.3)** | (0.6) |
| Onerous property leases | **(0.2)** | - |
| Vacation pay | **(0.5)** | - |
| Impairment of fixtures and fittings | **-** | - |
| **Other individually significant items** | **(1.2)** | (0.8) |
| **Total** | **(2.6)** | (3.1) |

## 4 Expenses and auditors' remuneration

| | **2017 £m** | 2016 £m |
|---|---|---|
| (Loss)/profit before taxation is stated after charging/ (crediting): | | |
| *Amounts receivable by auditors and their associates in respect of:* | | |
| Audit of these financial statements | **-** | - |
| Audit of financial statements of subsidiaries pursuant to legislation | **0.2** | 0.1 |
| Total audit | **0.2** | 0.1 |
| Review of interim financial statements | **-** | - |
| Total fees | **0.2** | 0.1 |
| | | |
| Depreciation of property, plant and equipment (Note 10) | **5.2** | 3.7 |
| Impairment of fixtures and fittings* (Note 10) | **0.9** | - |
| *Amortisation and other amounts written off intangible fixed assets:* | | |
| Amortisation of software (Note 9) | **2.0** | 1.6 |
| Amortisation of development costs (Note 9) | **1.5** | - |
| Amortisation of acquired intangibles (Note 9) | **10.3** | 6.8 |
| Impairment of goodwill* | **54.3** | 11.9 |
| Impairment of capitalised development costs* | **5.7** | 6.9 |
| Impairment of software costs* | **2.0** | - |
| *Operating lease rentals charged:* | | |
| • Hire of property, plant and equipment | **3.2** | 3.9 |
| • Other operating leases | **1.6** | 1.4 |
| Research and development expenditure | **1.7** | 2.2 |
| Profit on sale of discontinued operation* | **1.2** | - |
| Profit on disposal of plant and equipment | **(0.1)** | (0.1) |

*Included within individually significant items, Note 3.

The reclassification of costs relates to administrative salaries and travel costs that were reported within cost of sales in the prior year but have been reclassified to general and administrative expenses in this years' consolidated income statement.

## 5 Domain services

In June 2016, the Board took the decision to close down the activities of the Domain Services operating segment. During the prior year, the development activities of Domain Services were severely curtailed and the assets and business activities were either shut down or sold in the current financial year. This included the sale of the Open Registry group of companies comprising Open Registry SA, ClearingHouse for Intellectual Property SA, Nexperteam CVBA and Sensirius CVBA to external buyers for a combined total consideration of €3.75m in

January 2017, €2.0m receivable in immediate cash and €1.75m as deferred consideration, receivable in July 2018 at a fixed interest rate of 4%. A profit on disposal of £1.2m is recognised in the consolidated income statement within individually significant items (note 3).

The tables below provide an analysis of Domain Services activities for revenue, EBITDA and profit before tax as these are considered to be the most relevant to understanding underlying business performance.

| **Results of Domain services** | **2017 £m** | 2016 £m |
|---|---|---|
| Revenue | **2.6** | 4.9 |
| Expenses | **(2.7)** | (6.3) |
| EBITDA | **(0.1)** | (1.0) |
| Individually significant items | **-** | (18.7) |
| Depreciation and amortisation | **(0.1)** | (0.4) |
| Profit before tax | **(0.2)** | (20.1) |
| Gain recognised on sale | **1.2** | - |
| Profit/(loss) for the year | **1.0** | (20.1) |

| **Effect of the Open Registry Group sale on assets and liabilities** | **2017 £m** | 2016 £m |
|---|---|---|
| Intangible assets | **0.1** | 0.1 |
| Plant & Equipment | **0.1** | 0.1 |
| Trade and receivables | **3.2** | 2.5 |
| Cash and cash equivalents | **1.6** | 1.3 |
| Trade payables | **(5.2)** | (4.1) |
| **Net liabilities** | **(0.2)** | (0.1) |
| Consideration received, satisfied in cash | **1.7** | - |
| Cash disposed of | **(1.7)** | - |
| **Net cash inflow** | **-** | - |

## 6 Taxation

### Recognised in the income statement

| | **2017 £m** | 2016 £m |
|---|---|---|
| *Current tax expense* | | |
| Current year | **3.1** | 4.4 |
| Adjustment to tax expense in respect of prior periods | **-** | (0.5) |
| Foreign tax | **0.9** | 0.8 |
| Total current tax | **4.0** | 4.7 |
| Deferred tax (note 13) | **(2.7)** | (1.6) |
| Tax in income statement | **1.3** | 3.1 |

### Reconciliation of effective tax rate

| | **2017 £m** | 2016 £m |
|---|---|---|
| Profit before taxation | **(55.3)** | 9.4 |
| Current tax using the UK corporation tax rate of 19% (2016: 20%) | **(11.0)** | 1.9 |
| Effects of: | | |
| Items not taxable for tax purposes | **12.3** | 2.0 |
| Adjustment to tax charge in respect of prior periods | **(0.4)** | (0.2) |
| Differences between overseas tax rates | **0.2** | (0.5) |
| Movements in temporary differences not recognised | **0.6** | |
| Effect of rate change | **(0.4)** | (0.1) |
| Total tax expense | **1.3** | 3.1 |

Current and deferred tax recognised directly in equity was a debit of £0.2m (2016: charge of £0.6m). The UK Government has announced that it intends to reduce the rate of corporation tax to 17% with effect from 1 April 2020. This was substantively enacted in September 2016. As at the year end the impact of the anticipated rate change is reflected in the tax provisions reported in these accounts. Finance Act 2015 (No.2), which was substantively enacted in October 2015, included provisions to reduce the rate of corporation tax to 19% with effect from 1 April 2017. Accordingly, the UK deferred tax balances which were valued at the rate of 19% in the 31 May 2016 accounts have been revalued at the 17% rate in these accounts where relevant.

## 7 Dividends

| | **2017 £m** | 2016 £m |
|---|---|---|
| Dividends paid and recognised in the year | **12.8** | 10.3 |
| Dividends proposed but not recognised in the year | **8.7** | 8.7 |

| | | |
|---|---|---|
| Dividends per share paid and recognised in the year | **4.65p** | 4.18p |
| Dividends per share proposed but not recognised in the year | **3.15p** | 3.15p |

## 8 Earnings per share

The calculation of adjusted earnings per share is based on the following:

| | **2017 £m** | **2017 £m** | 2016 £m | 2016 £m |
|---|---|---|---|---|
| (Loss)/profit for the year from continuing operations used for basic and diluted earnings per share | | **(56.6)** | | 6.3 |
| Amortisation of acquired intangible assets (Note 9) | **10.3** | | 6.8 | |
| Domain Services net result | **(1.0)** | | 1.4 | |
| Individually Significant Items (Note 3) | **71.0** | | 18.9 | |
| Unwinding of discount | **0.5** | | 0.6 | |
| Share based payments | **0.6** | | 1.2 | |
| Tax arising on the above items | **(6.3)** | | (5.2) | |
| | | **75.1** | | 23.7 |
| Adjusted profit from continuing operations used for adjusted earnings per share | | **18.5** | | 30.0 |

| | **Number of shares m** | Number of shares m |
|---|---|---|
| Basic weighted average number of shares in issue | **276.3** | 254.6 |
| Dilutive effect of share options | **-** | 3.5 |
| Diluted weighted average shares in issue | **276.3** | 258.1 |
| Adjusted basic EPS | **6.7p** | 11.8p |

In the prior year, the average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period during which the options were outstanding.

The prior year did not treat Domain Services as an adjusting item as the decision to exit the business was taken after the end of the financial year. To be consistent with the current year, the prior year adjusting items have been amended to include the results of Domain Services. The net impact was to increase the prior year Adjusted EPS by 0.4p.

## 9 Intangible assets

| | Software | Development costs | Customer contracts and relationships | Goodwill | Total |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| **Cost:** | | | | | |
| At 1 June 2015 | 18.4 | 8.7 | 47.8 | 155.7 | 230.6 |
| Acquisitions through business combinations | 1.7 | - | 25.4 | 72.9 | 100.0 |
| Additions – internally developed | 6.9 | 1.9 | - | - | 8.8 |
| Costs write down | - | (6.8) | - | - | (6.8) |
| Effects of movements in exchange rates | - | 0.4 | 3.0 | 7.6 | 11.0 |
| **At 31 May 2016** | **27.0** | **4.2** | **76.2** | **236.2** | **343.6** |
| Acquisitions through business combinations | - | - | 7.7 | 12.1 | 19.8 |
| Additions – internally developed | 3.7 | 3.7 | - | - | 7.4 |
| Reclassification | (11.1) | 11.1 | - | - | - |
| Disposal of subsidiaries | | (0.1) | (3.4) | - | (3.5) |
| Effects of movements in exchange rates | 0.6 | 0.4 | 6.5 | 16.6 | 24.1 |
| **At 31 May 2017** | **20.2** | **19.3** | **87.0** | **264.9** | **391.4** |
| **Accumulated amortisation and impairment losses:** | | | | | |
| At 1 June 2015 | 7.7 | - | 17.8 | - | 25.5 |
| Charge for year | 1.6 | - | 6.8 | - | 8.4 |
| Impairment charge | - | - | - | 11.9 | 11.9 |
| Effects of movements in exchange rates | **-** | **-** | 0.5 | **-** | 0.5 |
| **At 31 May 2016** | **9.3** | **-** | **25.1** | **11.9** | **46.3** |
| Charge for year | 2.0 | 1.5 | 10.3 | - | 13.8 |
| Impairment charge | 2.0 | 5.7 | - | 54.3 | 62.0 |
| Reclassification | (2.1) | 2.1 | | - | - |
| Effects of movements in exchange rates | - | (0.2) | 1.9 | - | 1.7 |
| **At 31 May 2017** | **11.2** | **9.1** | **37.3** | **66.2** | **123.8** |
| Net book value: | | | | | |
| **At 31 May 2017** | **9.0** | **10.2** | **49.7** | **198.7** | **267.6** |
| At 31 May 2016 | 17.7 | 4.2 | 51.1 | 224.3 | 297.3 |

**Cash generating units (CGU's)**: Goodwill and intangible assets are allocated to CGUs in order to be assessed for potential impairment. CGUs are defined by accounting standards as the lowest level of asset groupings that generate separately identifiable cash inflows that are not dependent on other CGUs. Following the Strategic Review, the Directors have reconsidered the CGUs within the Group. The CGUs and the allocation of goodwill to those CGUs is shown in the table below. The table also includes the discount rate used to assess the NPV of the future cash flows of each CGU:

| Cash generating units | 2017 £m | 2017 Discount rate |
|---|---|---|
| Escrow UK | **22.9** | 11.4% |
| Escrow Europe | **8.3** | 11.8% |
| Escrow USA | **7.3** | 14.9% |
| **Total Escrow** | **38.5** | - |
| Assurance USA | **28.1** | 14.6% |
| PSC | **9.8** | 14.5% |
| VSR | **2.3** | 14.5% |
| UK Security Consulting | **18.5** | 12.6% |
| Fox-IT | **62.7** | 17.0% |
| Software Testing | **8.0** | 12.5% |
| Web Performance | **2.2** | 15.2% |
| Accumuli (known internally as MSS) | **28.6** | 15.4% |
| **Total Assurance** | **160.2** | - |
| **Total Group** | **198.7** | - |

In the prior year, the goodwill allocation and WACC rates for each CGU (in brackets) were: Escrow UK £21.2m (10.1%), Escrow Europe £6.4m (10.7%), Escrow USA £7.3m (12.9%), Assurance USA £24.6m (15.0%) and European Security Services £164.8m (11.2%).

The composition of the MSS business noted above (formerly known as Accumuli) is slightly different from the Accumuli Group at acquisition. One part of the Accumuli business, known as RandomStorm, carried on identical activities to some parts of UK Security Consulting. Those activities and their cash flows were transferred to UK Security Consulting during the year and are no longer separately managed or independent cash flows associated with MSS. Those cash flows and their associated share of goodwill is therefore included in the UK Security Consulting CGU.

During the year, the Group acquired Payment Software Company Inc, a global payment and security consulting company and Virtual Security Research LLC, (VSR) an information network and application security consulting company.

When assessing impairment, the recoverable amount of each CGU is based on value in use calculations. These calculations require the use of estimates, specifically: pre-tax cash flow projections; long-term growth rates; and a pre-tax market discount rate. Cash flow projections are based on the Group's detailed annual operating plan for the forthcoming financial year with assumptions applied for expected revenue growth and costs to forecast years two to five which are forecasts which have been approved by the Board. The judgement on these assumptions is based on management's past experience of growth and knowledge of the industry sectors and markets. The projections beyond five years are forecast using an estimated long-term growth rate of 2.5% (2015: 2.5%) which represents management's best estimate of a long term annual growth rate in EBITDA. A different set of assumptions may be more appropriate in future years dependent on changes in the macro-economic environment.

The discount rates used are based on management's calculation of the WACC using the capital asset pricing model to calculate the cost of equity. Specific rates are used for each CGU in the value in use calculation and the rates reflect management's assessment on the level of relative risk in each respective CGU. The pre-tax discount rates used in the value in use calculations are shown above.

The Directors have considered a range of sensitivities. If the discount rates used in each CGU were decreased or increased by 1%, the total Net Present Value of future cash flows would increase by £105m and decrease by £81m respectively. In the case of the CGUs where goodwill has been impaired in the current year, or where an impairment would potentially arise, the impairment amounts would increase/ (decrease) as follows:

| Cash generating units | **Discount rate 1% increase 2017 £m** | **Discount rate 1% decrease 2017 £m** |
|---|---|---|
| Fox-IT | **9.1** | (11.2) |
| MSS | **2.6** | (3.1) |
| Web Performance | **0.8** | (1.1) |
| **Total for units with impairments** | **12.5** | (15.4) |
| Software Testing | 0.2 | (1.9) |
| **Total for units with impairments and Software Testing** | **12.7** | (17.3) |

## 10 Plant and equipment

| | **Computer equipment £m** | **Plant and equipment £m** | **Fixtures and fittings £m** | **Motor vehicles £m** | **Total £m** |
|---|---|---|---|---|---|
| **Cost:** | | | | | |
| **At 1 June 2015** | **14.6** | **0.4** | **9.7** | **0.4** | **25.1** |
| Additions | 3.2 | - | 1.3 | 0.1 | 4.6 |
| Acquired as part of business combination | 0.9 | - | 1.0 | - | 1.9 |
| Disposals | (0.3) | - | - | - | (0.3) |
| Movement in foreign exchange rates | 0.2 | - | 0.2 | - | 0.4 |

| | | | | | |
|---|---|---|---|---|---|
| **At 31 May 2016** | **18.6** | **0.4** | **12.2** | **0.5** | **31.7** |
| Additions | 4.2 | 0.1 | 6.6 | 0.1 | 11.0 |
| Acquired as part of business combination | 0.5 | - | - | - | 0.5 |
| Disposals | (0.3) | (0.4) | (0.2) | (0.2) | (1.1) |
| Movement in foreign exchange rates | 0.8 | - | 1.0 | - | 1.8 |
| **At 31 May 2017** | **23.8** | **0.1** | **19.6** | **0.4** | **43.9** |
| | | | | | |
| **Depreciation:** | | | | | |
| **At 1 June 2015** | **11.3** | **0.4** | **3.9** | **0.1** | **15.7** |
| Charge for year | 1.9 | - | 1.7 | 0.1 | 3.7 |
| Disposals | (0.2) | - | - | - | (0.2) |
| Movement in foreign exchange rates | (0.1) | - | (0.1) | - | (0.2) |
| **At 31 May 2016** | **12.9** | **0.4** | **5.5** | **0.2** | **19.0** |
| Charge for year | 3.3 | - | 1.9 | | 5.2 |
| Impairment | - | - | 0.9 | - | 0.9 |
| Acquired as part of business combination | 0.4 | - | - | - | 0.4 |
| Disposals | (0.3) | (0.4) | (0.2) | (0.1) | (1.0) |
| Movement in foreign exchange rates | 0.6 | - | 0.4 | - | 1.0 |
| **At 31 May 2017** | **16.9** | **-** | **8.5** | **0.1** | **25.5** |
| | | | | | |
| **Net book value:** | | | | | |
| **At 31 May 2017** | **6.9** | **0.1** | **11.1** | **0.2** | **18.3** |
| At 31 May 2016 | 5.7 | - | 6.7 | 0.3 | 12.7 |

The £0.9m impairment of fixtures and fittings in the current head office property which is due for relocation later in the year is recognised as an "other individually significant item" in the consolidated income statement.

## 11 Trade and other receivables

| | **Group 2017 £m** | Group 2016 £m | **Company 2017 £m** | Company 2016 £m |
|---|---|---|---|---|
| Trade receivables | **40.9** | 39.4 | **-** | - |
| Prepayments | **6.6** | 7.2 | **-** | - |
| Other receivables | **1.5** | - | **-** | - |
| Accrued income | **17.7** | 19.8 | | |
| Amounts owed by group undertakings | **-** | - | **149.6** | 130.2 |
| | **66.7** | 66.4 | **149.6** | 130.2 |

The ageing of trade receivables at the end of the reporting period was:

### Group

| | **Gross 2017 £m** | **Impairment 2017 £m** | Gross 2016 £m | Impairment 2016 £m |
|---|---|---|---|---|
| Not past due | **19.8** | **-** | 25.0 | - |
| Past due 0-30 days | **12.1** | **-** | 9.0 | - |
| Past due 31-90 days | **7.7** | **-** | 4.7 | - |
| Past due more than 90 days | **2.0** | **(0.7)** | 1.4 | (0.7) |
| | **41.6** | **(0.7)** | 40.1 | (0.7) |

The Company had no trade receivables (2016: £Nil).

The Group establishes a provision for impairment that represents its estimate of incurred losses in respect of specific trade receivables. The movement in the provision for impairment was:

| | **Group 2017 £m** | Group 2016 £m |
|---|---|---|
| Balance at 1 June | **0.7** | 0.3 |
| (Utilised)/created in | **-** | 0.4 |
| **Balance at 31 May** | **0.7** | 0.7 |

## 12 Acquisitions

**Payment Software Company Inc**

NCC Group Inc acquired Payment Software Company Inc, (PSC) a company based in California, USA, on 28 September 2016. PSC is a global payment and security consulting company, providing services to organisations that require specialist compliance, forensics and consulting support.

The consideration paid was $16.6m initial cash consideration with contingent consideration payments of $1.9m, where the fair values are based on the estimated cash outflows discounted using a risk-adjusted discount rate, due on earn-out periods to 31 December 2017 and 31 December 2018. The two contingent payments are payable in cash on the achievement of specific profit based performance targets which we expect to be achieved based on current business forecasts. Accordingly, the full contingent consideration liability has been recognised at its fair value.

| Acquiree's identifiable net assets at the acquisition date: | £m | Fair values £m |
|---|---|---|
| Intangible assets - acquired | | 5.7 |
| Trade and other receivables | | 1.5 |
| Deferred tax liability | | (2.0) |
| Cash | | 1.8 |
| Creditors & accruals | | (1.2) |
| Net identifiable assets | | 5.8 |
| Goodwill on acquisition | | 9.8 |
| **Total consideration** | | **15.6** |
| Satisfied by: Initial cash consideration | 12.8 | |
| Deferred cash consideration | 3.0 | |
| Finance discount on deferred consideration | (0.2) | |
| | **15.6** | |
| **Net cash outflow** | | **12.8** |
| Cash acquired | | (1.8) |
| **Net cash outflow excluding cash acquired** | | **11.0** |

The goodwill of £9.8m represents the benefits expected to be generated from sales and profit growth from the wider NCC customer base in the US market. The goodwill is not expected to be deductible for tax purposes. Acquisition costs relating to professional fees totalling £0.4m were incurred and are recognised as individually significant items in the income statement (note 3). The Group's consolidated income statement includes eight month's post acquisition trading, with PSC Inc contributing £5.9m revenue and £1.2m operating profit.

**Virtual Security Research LLC**

NCC Group Inc acquired Virtual Security Research LLC, (VSR) a company based in Boston, Massachusetts, USA, on 11 November 2016. VSR is an information, network and application security consulting company providing services to corporate clients of varying sizes primarily in the US Technology and Financial Services sectors.

The consideration paid was $3.7m initial cash consideration with contingent consideration payments of $0.9m, where the fair values are based on the estimated cash outflows discounted using a risk-adjusted discount rate, due on earn out periods to 31 December 2017 and 31 December 2018. The two contingent payments are payable in cash on the achievement of specific profit based performance targets which we expect to be achieved based on current business forecasts. Accordingly, the full contingent consideration liability has been recognised at its fair value.

| Acquiree's identifiable net assets at the acquisition date: | Fair values £m | £m |
|---|---|---|
| Intangible assets - acquired | | 2.0 |
| Trade and other receivables | | 0.5 |
| Cash | | 0.1 |
| Creditors & accruals | | (0.7) |

| | | |
|---|---|---|
| Net identifiable assets | | 1.9 |
| Goodwill on acquisition | | 2.3 |
| **Total consideration** | | **4.2** |
| Satisfied by: Initial cash consideration | 2.9 | |
| Deferred cash consideration (no impact from discounting) | 1.3 | |
| | **4.2** | |
| **Net cash outflow** | | **2.9** |
| Cash acquired | | 0.1 |
| **Net cash outflow excluding cash acquired** | | **2.8** |

The goodwill of £2.3m represents the benefits expected to be generated from sales and profit growth from the wider NCC customer base in the US market. The goodwill is expected to be deductible for tax purposes. Acquisition costs relating to professional fees totalling £0.2m were incurred and are recognised as individually significant items in the income statement (note 3). The Group's consolidated income statement includes six full months of post-acquisition trading, with VSR contributing revenue of £1.1m and operating profit of £0.5m.

### Fox-IT Holdings BV

In the prior year, NCC Group (Solutions) Limited acquired Fox-IT Holdings BV, a company based in the Netherlands. Fox-IT has a leading market position in Europe for high-end Cyber Security solutions and is a leading European provider of Advanced Incident Response Services. Fox-IT's activities of Advanced Threat Protection, Threat Intelligence and Web/Mobile Event Analytics, High Assurance and Secure Infrastructure, provide further depth to NCC's cyber and assurance services and growth opportunities from new markets.

The consideration for the acquisition of Fox-IT was €108,250,000 initial cash, with deferred payments due on each of the first and second anniversaries of completion comprising, €10,000,000 cash and €2,500,000 newly issued NCC Group plc shares each. The first deferred payment was paid in November 2016 and the Directors agreed to make this payment fully in cash consideration. Accordingly, a payment of €12,500,000 was made to the former owners.

The acquisition had the following effect on the Group's assets and liabilities:

| **Acquiree's identifiable net assets at the acquisition date:** | **£'000** | **Fair values £'000** |
|---|---|---|
| Plant and equipment | | 1.9 |
| Intangible assets – development | | 1.7 |
| Intangible assets - acquired | | 25.4 |
| Trade and other receivables | | 7.3 |
| Inventory | | 0.4 |
| Deferred tax liability | | (6.0) |
| Cash | | 1.8 |
| Creditors & accruals | | (7.5) |
| Deferred revenue | | (2.1) |
| Net identifiable assets | | 22.9 |
| Goodwill on acquisition | | 70.9 |
| **Total consideration** | | **93.8** |
| Satisfied by: Initial cash consideration | 76.6 | |
| Deferred cash consideration | 14.4 | |
| Deferred issue of equity shares consideration | 3.6 | |
| Finance discount on deferred consideration | (0.8) | |
| | **93.8** | |
| **Net cash outflow** | | **76.6** |
| Cash acquired | | (1.8) |
| **Net cash outflow excluding cash acquired** | | **74.8** |

The fair value of trade and other receivables represents £7.5m of gross contractual receivables and a provision for doubtful debts of £0.2m.

The goodwill of £70.9m represents the value to be generated from cross-selling Fox-IT products and services to existing group customers, sales growth from new customers in wider geographic markets and from future product development using the knowledge and expertise of the Fox-IT technical team. The goodwill is not expected to be deductible for tax purposes. Acquisition costs relating to professional fees totalling £1.9m were incurred and are recognised as individually significant items in the income statement account (note 3).

The Group's prior year consolidated income statement includes six month's post acquisition trading, with Fox-IT contributing £14.0m revenue and £1.3m operating profit. The combined results of NCC and Fox-IT B.V. for the twelve month period ending 31 May 2016 were revenue of £218.2m and operating profit before individually significant items of £30.5m.

The balances presented below are valued at the fair value of amounts payable and in respect of contingent consideration on acquisitions. The contingent consideration is stated at the maximum amount payable as it is believed that on current trading performance the full contingent consideration will be due.

| Contingent consideration | **2017**<br>**£m** | 2016<br>£m |
|---|---|---|
| FortConsult A/S | **-** | 1.8 |
| Payment Software Company | **2.8** | - |
| Virtual Security Research | **1.3** | - |
| ArmstrongAdams Limited | **-** | 1.7 |
| | **4.1** | 3.5 |

The amounts outstanding in May 2016 in respect of FortConsult A/S and Armstrong Adams Limited were paid in full during the year

| Deferred consideration | **2017**<br>**£m** | 2016<br>£m |
|---|---|---|
| Fox-IT Holdings B.V. | **10.7** | 18.5 |
| | **10.7** | 18.5 |

## 13 Deferred tax assets and liabilities

### Group

Recognised deferred tax assets and liabilities are attributable to the following:

| | **Assets** | | **Liabilities** | | **Net** | |
|---|---|---|---|---|---|---|
| | **2017**<br>**£m** | 2016<br>£m | **2017**<br>**£m** | 2016<br>£m | **2017**<br>**£m** | 2016<br>£m |
| Plant and equipment | **-** | - | **(1.9)** | (2.2) | **(1.9)** | (2.2) |
| Short term temporary differences | **1.4** | 1.8 | **-** | - | **1.4** | 1.8 |
| Intangible assets | **-** | - | **(12.3)** | (13.3) | **(12.3)** | (13.3) |
| Share based payments | **0.3** | 0.8 | **-** | - | **0.3** | 0.8 |
| Tax losses | **2.5** | 2.7 | **-** | - | **2.5** | 2.7 |
| Deferred tax asset/(liability) | **4.2** | 5.3 | **(14.2)** | (15.5) | **(10.0)** | (10.2) |

Movement in deferred tax during the year:

| | 1 June 2016<br>£m | Recognised in income<br>£m | Exchange differences<br>£m | Recognised in equity<br>£m | Acquisitions<br>£m | **31 May 2017**<br>**£m** |
|---|---|---|---|---|---|---|
| Plant and equipment | (2.2) | 0.3 | - | - | - | **(1.9)** |
| Short term temporary differences | 1.8 | (0.4) | 0.1 | - | - | **1.4** |
| Intangible assets | (13.3) | 3.1 | (0.9) | - | (1.2) | **(12.3)** |
| Share based payments | 0.8 | (0.1) | - | (0.4) | - | **0.3** |
| Tax losses | 2.7 | (0.2) | - | - | - | **2.5** |
| | (10.2) | 2.7 | (0.9) | (0.4) | (1.2) | **(10.0)** |

| | 1 June 2015 | Recognised in income | Exchange differences | Recognised in equity | Acquisitions | 31 May 2016 |
|---|---|---|---|---|---|---|

| | £m | £m | £m | £m | £m | £m |
|---|---|---|---|---|---|---|
| Plant and equipment | (0.4) | (1.8) | - | - | - | (2.2) |
| Short term temporary differences | 0.5 | 0.8 | 0.1 | - | 0.4 | 1.8 |
| Intangible assets | (9.7) | 3.3 | (0.5) | - | (6.4) | (13.3) |
| Share based payments | 0.5 | (0.1) | (0.1) | 0.5 | - | 0.8 |
| Tax losses | 3.3 | (0.6) | - | - | - | 2.7 |
| | (5.8) | 1.6 | (0.5) | 0.5 | (6.0) | (10.2) |

The Group has recognised a deferred tax asset of £2.5m (2016: £2.7m) on tax losses as management consider it probable that future taxable profits will be available against it can be utilised. The Group has not recognised a deferred tax asset on £6.2m (2016: £5.7m) of tax losses carried forward due to uncertainties over their future recovery.

Included in recognised and unrecognised tax losses are losses of £2.9m that will expire in 2034 (2016: £3.5m). Other losses may be carried forward indefinitely.

No deferred tax liability is recognised on temporary differences of £nil (2016: £0.2m) relating to the unremitted earnings of overseas subsidiaries as the Group is able to control the timing of the reversal of these temporary differences and it is probable that they will not reverse in the foreseeable future.

## 14 Trade and other payables

| | **Group 2017 £m** | Group 2016 £m | **Company 2017 £m** | Company 2016 £m |
|---|---|---|---|---|
| Trade payables | **4.3** | 7.9 | **-** | - |
| Consideration on acquisitions (note 12) | **12.9** | 3.5 | **-** | - |
| Non trade payables | **6.7** | 7.6 | **-** | - |
| Accruals | **18.7** | 16.1 | **-** | - |
| Property provisions (note 16) | **1.5** | - | **-** | - |
| Intercompany payables | **-** | - | **-** | 10.6 |
| | **44.1** | 35.1 | **-** | 10.6 |

## 15 Deferred revenue

| | **Group 2017 £m** | Group 2016 £m |
|---|---|---|
| Deferred revenue | **35.6** | 36.3 |

Deferred revenue consists of: Escrow agreements £13.5m (2016: £13.2m), Assurance contracts £19.2m (2016: £17.1m), Website monitoring and load testing agreements of £2.9m (2016: £3.4). There are no Domain services deferred revenue contracts as the entity was disposed of during FY17 (2016: £2.6m). The revenue has been deferred and is released to the income statement over the contract term in accordance with the Group's accounting policy.

## 16 Non-current liabilities

| | **Group 2017 £m** | Group 2016 £m |
|---|---|---|
| Secured and interest bearing bank loan | **56.0** | 33.4 |
| Deferred tax (note 13) | **14.2** | 15.5 |
| Consideration on acquisitions (note 12) | **2.1** | 18.5 |
| Property provisions | **3.5** | 0.4 |
| Total non-current liabilities | **75.8** | 67.8 |

Total Property provisions of £5.0m represents capital contributions of £3.7m towards fit out costs on the new Manchester Head Office building and a rent free allowance of £1.3m which is being amortised over the period of the lease. The capital contribution provision of £3.7m will be released to the Income Statement over the same period as the assets in question are being depreciated (i.e. 10 years).

## 17 Cash and cash equivalents

| Cash flow from operating activities | Notes | 2017 £m | 2016 £m |
|---|---|---|---|
| (Loss)/profit for the year | | **(56.6)** | 6.3 |
| Adjustments for: | | | |
| Depreciation | 10 | **5.2** | 3.7 |
| Depreciation – individually significant item | 3 | **0.9** | |
| Share based charges | | **0.6** | 1.1 |
| Amortisation of intangible assets | 9 | **13.8** | 8.4 |
| Net financing costs | | **1.9** | 2.0 |
| Profit on sale of plant and equipment | 4 | **(0.1)** | (0.1) |
| Impairment of intangible assets | 3 | **7.7** | 6.9 |
| Impairment of goodwill | 3 | **54.3** | 11.9 |
| Other individually significant items | | **6.0** | (6.0) |
| Profit on disposal of subsidiaries | 5 | **(1.2)** | - |
| Income tax expense | 6 | **1.3** | 3.1 |
| **Cash inflow for the year before changes in working capital** | | **33.8** | 37.3 |

| | At beginning of year £m | Cash flow £m | Non cash items £m | **At end of Year £m** |
|---|---|---|---|---|
| **Cash and cash equivalents per cash flow statement** | 20.7 | (6.0) | (2.4) | **12.3** |

Non-cash items principally relate to the effects of foreign currency.

## 18 Related party transactions

During the year corporate finance fees of £0.3m (2016: £0.8m) and professional fees for services of Paul Mitchell of £nil (2016: £37,500) as Non-Executive Chairman were paid to Rickitt Mitchell & Partners Ltd. Paul Mitchell held the positions of Non-Executive Chairman of NCC until 31 May 2017 and is a Non-Executive Chairman of Rickitt Mitchell & Partners Ltd.