TalkTalk Group

# Annual Report 2016

## TalkTalk Telecom Group PLC

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# TalkTalk is the UK's leading value for money quad play provider.

Our mission is to deliver **affordable, reliable, simple, and fair** telecoms services for everyone.

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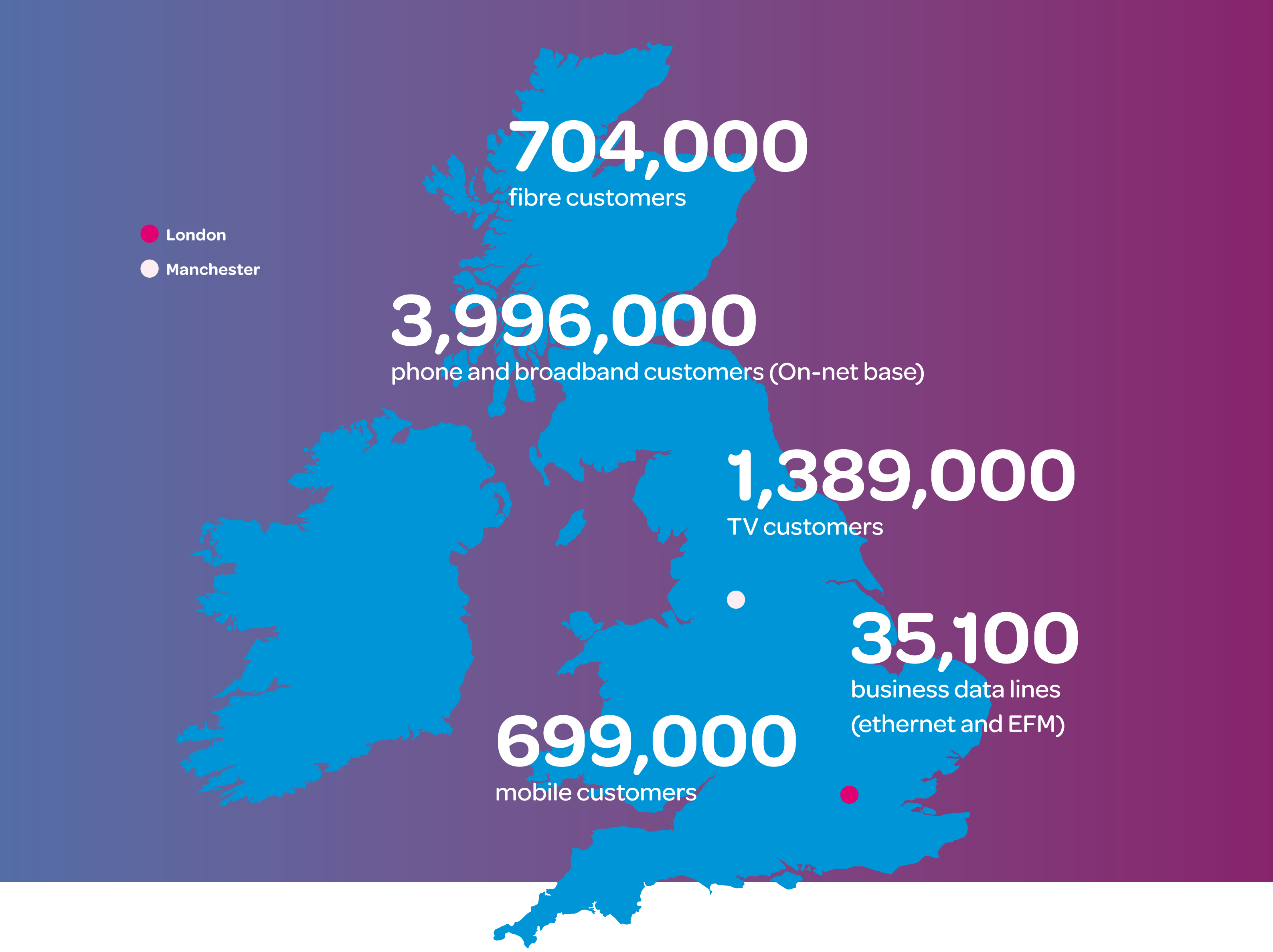



> "The business bounced back strongly in the final quarter. We recorded our lowest ever churn: testimony to the speed with which customer sentiment has recovered, the success of our greater focus on existing customers, and the growing benefits of our simplification programme."
>
> **Dido Harding,** Chief Executive Officer

**Services to consumers**

TalkTalk provides value for money phone, broadband, fibre, TV, and mobile to UK homes, differentiated by a clear and simple tariff structure, low prices, flexibility and the inclusion of valuable services, such as unlimited broadband usage and HomeSafe®, our market-leading network-based security service. We also offer mobile services to our phone and broadband customers through a Mobile Virtual Network Operator (MVNO) agreement with Vodafone that will transition to a new MVNO relationship with Telefónica UK during 2017. Our TV proposition, which is uniquely non-subscription based, includes access to the TalkTalk TV Store for all broadband customers and a free YouView set top box for those customers taking our bundled phone, broadband and TV packages. YouView is an internet-enabled television service with differentiated catch-up and on-demand services, and an open platform for future application-driven innovation.

**Services to businesses**

TalkTalk Business (TTB) serves the needs of over 180,000 businesses from national retailers to sole traders and public sector customers nationwide. TTB offers a wide range of voice, data connectivity products and interconnection services to business customers and other carriers. TTB is one of only two network providers in the UK to provide wholesale connectivity services, with large national Internet Service Providers (ISPs) such as the Post Office and Telecom Plus amongst its customers.

TTB also offers competitively priced high speed connectivity products such as Ethernet and Ethernet in the First Mile (EFM) that exploit the Group's significant network capability and reach. Data revenues are the fastest growing product set by revenue in the Group's range to Corporates, with a significant and accelerating pipeline. TTB's voice products comprise of legacy revenues and the Group's newly launched, next generation voice over internet protocol (VOIP) product.

# Strategic report

# At a glance

## With a network that reaches 96% of the country, TalkTalk is the UK's leading provider of value for money fixed line voice telephony and broadband services to consumers and businesses. Our fast growing B2B business also offers a wide range of data connectivity and next generation voice products across the UK.

**Our history**

Created in 2004 as the telecommunications division of The Carphone Warehouse Group (CPW), a retailer of mobile phones and related products, TalkTalk was demerged and listed on the London Stock Exchange in 2010.

TalkTalk has a long history of positive disruption and challenging industry conventions. Having launched a market-beating voice offer in 2004, TalkTalk began building its unbundled local loop network in 2005. A decade ago this year, the Company launched the UK's first ever free broadband offer. This marked a pivotal moment in the evolution of the UK telecoms sector, and firmly established TalkTalk as the value for money champion in the market.

Increased competition and uptake in connectivity services, coupled with a compelling pricing proposition, fuelled significant growth for the business over subsequent years. Through a combination of acquisitions and organic growth, TalkTalk expanded rapidly, acquiring the businesses of AOL UK and Tiscali UK in 2007 and 2009 respectively. In 2010, the business began offering additional consumer services in the form of mobile SIMs. It completed its suite of quad play services with the launch of a flexible, value for money pay TV service and mobile handsets in 2012.

TalkTalk also offers fixed line connectivity services to business customers (B2B), including high speed Ethernet products and innovative next generation voice products. Founded in 1995 as Opal Telecom, TalkTalk Business (TTB) has capitalised on the scale, performance and reach of the TalkTalk network to create a portfolio of business grade connectivity and hosted solutions, available either direct or through a wide range of wholesale partners.

TTB has consistently demonstrated significant growth and is the only wholesale provider of broadband and Ethernet connectivity outside of BT Group. It now serves over 180,000 businesses across the UK.

**Our business model**

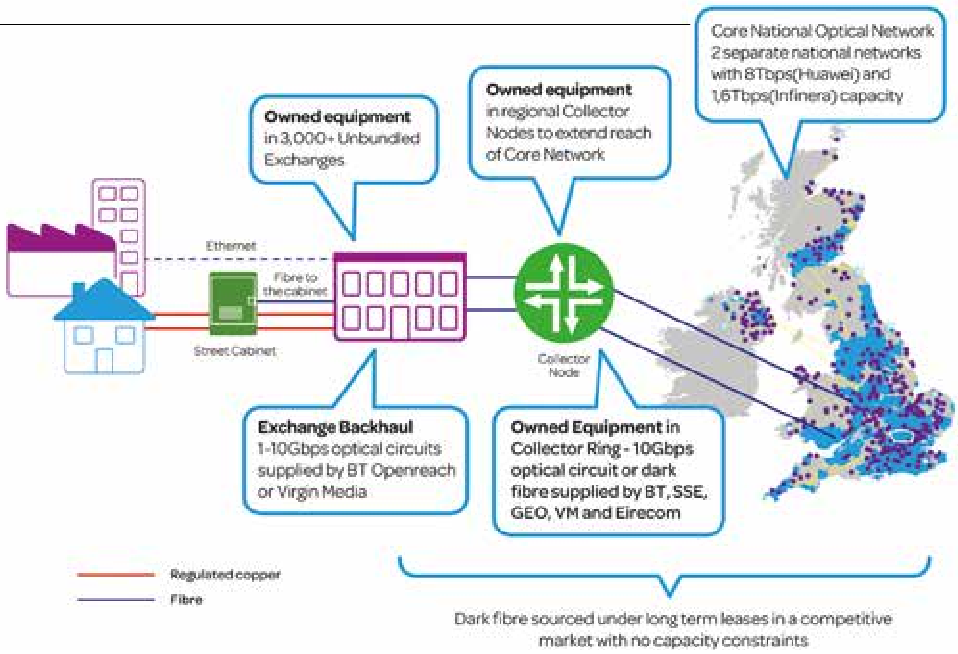
TalkTalk's network comprises owned equipment that the Company has installed in over 3,000 BT exchanges and linked back to a national high speed fibre backbone through a series of collector rings. The scale and reach of this architecture (the largest unbundled network in the country) gives the Company geographic coverage of 96% of the UK. This is a significant competitive advantage and barrier to entry.

Our business model is underpinned by a sustainable regulatory cost advantage over access to key parts of BT's network infrastructure; and a low cost operating model, which together allow us to price competitively. The political and regulatory environment in which this framework evolves is critical to TalkTalk's business model and is currently undergoing a series of reviews which present significant opportunities for the Company.

**Our ambition**

TalkTalk believes reasonably priced, reliable telecoms services should be available to everyone . We have always aimed to be the leading value for money provider for all our products and there has never been a clearer space for a trusted value champion in the market. Our ambition is to continue to build a scale consumer quad play business that consistently delivers affordable, reliable, simple and fair telecoms services for everyone. As the value champion in the B2B market we aim to double the size of TTB by growing its presence in the small business market, Ethernet connectivity and next generation voice products.

## Our infrastructure




For more information see our FY16 business review on page 5

# Chairman's statement

In a challenging and eventful year, in which TalkTalk was the victim of a major cyber attack, the business has continued to make operational and financial headway, ending the year strongly and well placed for the future.

We ended the year with nearly a fifth of our phone and broadband customers taking mobile and fibre, and over a third taking TV, all of which is a testament to our growing credentials as a true value for money quad play operator. In our B2B business, we saw continued strong growth in revenues from high speed data connectivity as well as good growth in our wholesale channel. As a result, we reported Group revenue growth of 2.4%.

Equally, whilst there is much more to do here, our Making TalkTalk Simpler programmes delivered significant improvements to customer experience, and reduced costs. As a result, we delivered profit growth of over 6% across the year and a strong improvement in margins during the second half.

I am pleased to report therefore that the Board has declared a final dividend of 10.58p which, in addition to our interim dividend of 5.29p, gives a total pay-out for the year of 15.87p or 15% higher year on year.

I am enormously proud of how TalkTalk responded to the cyber attack. By communicating honestly with our customers to help them protect themselves, we not only set a new standard of openness and transparency for large businesses dealing with such challenges, we also demonstrated that TalkTalk is a business brave enough to put our customers' interests first. Our customers responded positively to this, and have rewarded us with greater trust and loyalty, helping us deliver our best ever quarter of customer loyalty and much improved trust in our brands.

The impact on the business has clearly been considerable, and we have been determined to use this experience as an opportunity to take a comprehensive look at our organisation. As a result, we have made many positive changes to reinforce governance processes, especially around risk assessment and security – not just in technology and operations, but across our entire corporate culture. These changes will drive clearer priorities and strengthen our processes as we build a scale quad play business that consistently delivers great value and service to consumers and businesses. Crucially, they will also help to ensure TalkTalk, and our customers, are as well defended as we can be against future threats.

There has never been a clearer space in the market for a trusted value champion that puts its customers first and is truly affordable, reliable, simple and fair. Our employees are excited about delivering this mission and the Board and I would like to thank them for their efforts and their continuing commitment to TalkTalk and our customers.

**Sir Charles Dunstone**
**Chairman**
12 May 2016

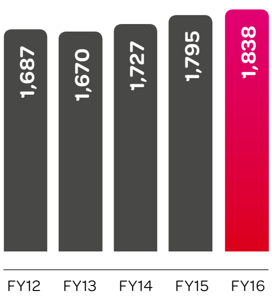
Financial metrics above refer to Headline financials.

## Operational highlights

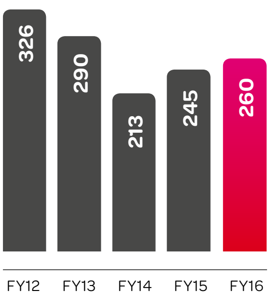
- TalkTalk has recovered strongly since the cyber attack, and customers have responded well to our open and honest approach
- Churn improved significantly during Q4 and at 1.3%, reaching its lowest level in our history. Focusing on existing customers is delivering benefit for the business
- Continued acceleration in Mobile and Fibre, with further expansion planned
- Deeper engagement with TV customers; TalkTalk TV Store launched
- Corporate remains a key engine of profitable growth; data connections growing strongly
- Making TalkTalk Simpler programme made significant progress in improving customer service, and achieved £21m of cost savings in the year

## Financial highlights

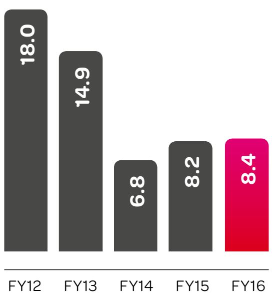
**Headline revenue** (£m)
+2.4%



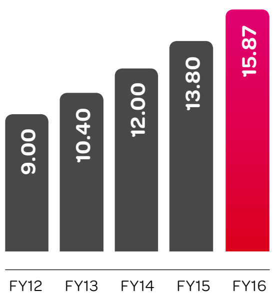

**Headline EBITDA** (£m)
+6.1%




**Headline EPS** (p)
+2.4%




**Dividend per share** (p)
+15.0%



# Chief Executive Officer's review

## FY16 business review

We made considerable progress during the year towards our strategic ambition of becoming the UK's leading value for money quad play operator and delivered FY revenue growth of 2.4% and Headline EBITDA in line with our revised guidance of £260m.

The cyber attack in Q3 drove elevated churn for a short period. An extended period through which we were unable to trade effectively also led to delays in implementing a number of initiatives in the Making TalkTalk Simpler Programme (MTTS). However, as expected, H2 still showed a strong step up in profitability with Headline EBITDA margin of 18.4% (H1: 9.9%), helped by the benefits of MTTS coming through strongly, and lower SAC and marketing costs.

The actions we took following the cyber attack to focus on our existing customers and to restore normality have more than mitigated any lasting impact on the business. This focus, together with the customer experience benefits of MTTS , helped us to stabilise the broadband base in Q4; drive strong growth in Revenue Generating Units (RGUs); and deliver the lowest ever churn in our history (1.3%). Equally the learnings from our detailed review of systems and processes following the cyber attack have helped us to prioritise elements of our trading approach and strategy, which will help us deliver material improvements in profitability in FY17.

The Board has recommended a final dividend of 10.58p taking the full year dividend to 15.87p, 15% higher year on year, and in line with our commitment.

## Broadband

**Base stabilised and significant improvement in churn in Q4**

We ended FY16 with an On-net base of 3,996k customers taking our core phone and broadband service (FY15: 4,177k).

The change in the base reflects two principal effects:

- an adjustment arising from a change in credit terms from 180 days to the industry standard of 90 days, which resulted in 72k non-paying customers being disconnected during H1; and
- a 95k impact in Q3 resulting from the cyber attack, reflecting churn in the immediate aftermath of the attack and much lower additions activity as it took longer than expected to return the business to normal sales effectiveness.

The balance of the fall of 14k reflects underlying activity of -8k in H1 and -6k in Q3, with Q4 net adds flat. We also completed the migration of Tesco broadband customers, and saw continuing growth in our profitable B2B wholesale broadband base to 830k (FY15: 737k).

While average churn across the year was 1.6% (including the cyber related churn), we saw a significant improvement in Q4 to 1.3%.

## Mobile

**Fast growing quad play penetration; 13.5% share of SIM-only market in the year**

The mobile base grew strongly in FY16 with 235k net adds taking the total base to 699k customers, 19% of the base compared to 12% a year ago. We saw strong take-up of bundled SIMs by our Plus TV customers, and further strong growth across our other value for money SIMs including over the summer, our Unlimited SIM. We also launched, in TalkTalk Business, our new O2 mobile proposition for business customers. In aggregate these value for money propositions helped drive our share of the new acquisitions SIM-only market to 13.5% in the year (FY15: 10.3%), second only to the market leader EE.

We have a defined three stage plan to build out our mobile business which will see further expansion of the base, growing revenues and profitability.

### Phase 1 – FY16/17

We began the build of our new billing system and other associated functionalities such as CRM and network migration development during H1. On completion of the new systems we will be able to launch 4G and national roaming services on our new MVNO agreement with Telefónica UK (O2) and extend our full mobile proposition to business customers. The new system suite will allow us to manage our own number range with TalkTalk SIMs, offer mobile sales and service capability through multiple channels, and provide increased self service capability for customers. We will complete billing and CRM migration in H2 FY17, and begin customer migration from Vodafone to Telefónica UK. This process will involve a SIM swap and we will take a careful approach to the planning of this transfer in order to minimise customer disruption.

The economics of our mobile proposition are expected to improve materially as we move customers from Vodafone to O2, with the full benefit being seen in FY18.

### Phase 2 – FY17/18

Our MVNO agreement with O2 also provides an opportunity to move to a deeper integration with O2's radio access network through the building of a 'thick' core system. This will allow us to control much more of our customers' mobile experience including real time management of traffic, alignment with our converged (fixed and mobile) infrastructure for creating truly integrated quad play propositions, and work with other network providers e.g. for national roaming. We have begun to develop our plans for the thick core, including some early testing of the necessary hardware equipment. We shall continue detailed planning and testing through FY17 with a view towards full implementation in early FY18.

Moving our customers onto the thick core will further improve the economics of our mobile business.

**Mobile** continued

### Phase 3 – FY18+

Our thick core will also enable us to roll out femto cells across our fixed line base, thus creating an inside-out fixed-mobile network that will leverage our Guard band spectrum. Ofcom is currently consulting the industry on our request to vary the Guard band licence for 4G usage and we expect a resolution in the summer. Femto cells on 4G spectrum will vastly improve customers' in-home mobile experience, especially in areas with poor radio network coverage, and will allow us to offload mobile traffic onto our fixed line network, thus delivering savings on MVNO costs. We began laboratory testing of femto cells during FY16, and have seen encouraging results on off-load capability and service quality. We expect roll-out to commence once the thick core is fully functional.

Over time there will be further opportunities to drive down data costs across this inside-out network, potentially by building a larger small-cell network combined with suitable high frequency spectrum.

## Fibre

**Continuing strong growth with 225k net adds in year and improved customer experience**

We added 225k net new fibre customers during the year, taking the base to 704k, 19% of the broadband base compared to 13% a year ago. Demand has been helped by customers' growing recognition of the benefits of higher speeds and bandwidths, and the availability of our self-install option which is used by over 90% of customers. Fibre customers are amongst our most satisfied customers with strong net promoter scores and significantly lower propensity to call, which is driving lower churn compared to broadband customers.

We have continued to improve our customers' experience of fibre by investing in our backhaul network and ended the year with significant improvements in network performance. Over the next two years we will invest further in enhancing the capability of our next generation access and edge networks, which will drive significant further improvements in customer satisfaction and reduce our operating costs.

We are making significant progress meeting the key operating metrics (cost per home passed, customer experience and penetration) in Ultra Fibre Optic (UFO), our fibre to the premise (FTTP) trial in York. We completed the build of the first 8,000 homes at a cost of under £500 per home and are now testing penetration. Customer trials ended at the end of March, when we launched the proposition commercially. Over 90% of the trial participants have chosen to retain the service and pay £21.70 per month which is particularly notable, as the vast majority were not existing TalkTalk customers. After two months TalkTalk UFO penetration stands at 7% of homes passed and continues to accelerate. Feedback from the first customers has been extremely positive and we are polling customers in other York neighbourhoods to establish interest for the next phase of building.

Based on these experiences, we remain confident about the potential to roll out FTTP at scale. At a build cost of under £500 per premise passed and 30%–40% take-up, we believe it will be possible to build a c.10 million household network across the UK. We see UFO as an opportunity to build a mass market, value for money proposition that delivers value for consumers and shareholders through keen pricing and rapid scaling. We expect to review progress and decide on the next phase of development later in the year.

## TV

**Over one-third of base taking TV; growing engagement with product**

The TV base declined modestly during the year by 25k to 1,389k as we focused on deepening the engagement with our existing TV customers. With over a third of our base now taking TV the product has been a remarkable success story for us in driving triple play growth with 1.4 million customers (38% of our phone and broadband base) from launch four years ago. Customers genuinely value the YouView experience that integrates free, Pay, OTT, and premium channels, and we see benefits to engagement, NPS, and churn. In addition, we have seen growing purchases of transactional video as customers become more comfortable and knowledgeable with the range of content on offer, with on-demand usage growing 20% year on year.

We are now evolving the proposition for the future, based on what our value conscious customers want, which is access to the widest range of content, on flexible terms and on multiple devices. Amongst other developments, TalkTalk TV customers can now sign up and pay for Netflix on their TalkTalk bill, and from June 2016, will be able to subscribe to BT Sport channels in addition to our existing portfolio of all Sky Sports channels.

In April we launched the TalkTalk TV store, which enables all of our customers, including broadband only customers, to access pay TV content on multiple devices. This is an important development on our TV journey, using the technology we acquired from blinkbox, as a set top box will no longer be the only way to gain access to a broad range of TalkTalk TV content.

## TalkTalk Business

**Delivering high margin growth through data**

TalkTalk Business revenues account for over 30% of the Group and grew by over 5% during the year. It is a significant, profitable and fast growing part of the Group and our ambition is to double its size over the medium term driven by continuing growth in data products, next generation voice services and broadband customer base growth delivered via our direct and partner (wholesale) channels.

The On-net wholesale base (TTB is one of only two national wholesalers of broadband and fibre to the cabinet), comprising the retail customers of businesses such as the Post Office and Utility Warehouse, was not directly affected by the cyber attack and therefore grew year on year, as did TTB's Direct channel On-net base.

Corporate revenues within TTB were up 2.4% against a strong prior year comparative (FY15: +10.3%), with compound annual growth since FY14 of over 6.0%.

Data revenues once again grew strongly (+23.7%), with over 9,000 new high speed data lines connected and a strong pipeline of orders at the year end. High speed data now accounts for 31% of our Corporate revenue. Business demand for high speed data is growing fast and TalkTalk Business is well placed to provide value for money high speed connectivity that is margin accretive. The main constraint to this growth continues to be BT Openreach's inability to provision orders on time.

Carrier revenues grew strongly in H1 (+34.1%) but as expected, were flat year on year in H2, with full year growth at 13.3%, and are expected to remain broadly stable in FY17. Voice revenues continued to decline (-16.2%) in line with market trends. During the year we acquired and integrated tIPicall, a leader in Next Generation Voice services. Customer reception to the new products launched on the back of this acquisition has been very positive, and we expect the rate of decline in total voice to moderate as this business grows.

### Making TalkTalk Simpler

MTTS is our wide ranging transformation programme that is delivering material improvements to our customers' experience, driving operating cost savings, and reducing subscriber acquisition costs (SAC) through lower churn and costs per add (CPA).

We made significant progress in FY16, achieving £21m of cost savings in the year through, amongst other things:

- better network performance from improved traffic management and the deployment of faster backhaul circuits;
- fewer missed engineer appointments and improved resolution of problem orders through case management;
- the implementation of live chat and voice biometrics; and
- improved fault diagnosis and resolution, reducing engineering cost and unnecessary customer contacts.

The cyber attack in Q3 highlighted the need to put our existing customers first and to accelerate the development of even more secure, simplified and resilient processes. MTTS is at the heart of this process and whilst we had to reprioritise some work-streams as a result of redirecting online resources to addressing the cyber attack, we exited the year on track to deliver £35m–£40m incremental benefits in FY17. In total therefore, we expect cumulative benefits from the start of the programme in FY13, to reach c.£90m by the end of FY17. With considerable further benefits to come from the programme, savings beyond FY17 are expected to annualise at a substantially higher level.

### TalkTalk network

**Leveraging our capability and enhancing customer's experience**

Our network gives us a significant competitive advantage as we look towards building upon our value for money positioning. At the heart of our network, is the unbundling equipment (digital subscriber line access multiplexers, multi-service access nodes and Ethernet switches) that we have installed in over 3,000 BT exchanges, giving us c.96% coverage of the UK – the largest such deployment in the UK and a significant barrier to entry. This allows us to take control of the copper line that connects customer premises to the exchange, at a regulated cost that has fallen over time.

The exchanges are connected via collector nodes that aggregate all of the 3,000+ exchanges and connect these to the core network. The equipment in these locations (a mixture of BT Openreach exchanges and our own data centres) is owned by TalkTalk. The nodes are connected by 10 Gigabits per second circuits to the core network for delivery of voice and data services. These circuits are either leased bandwidth or leased dark fibre, both of which are well-served markets.

Our dark fibre core optical network is the fundamental underlay of the network – a high speed, high-capacity all-IP national backbone that enables efficient and flexible routing of voice and data traffic. The size and all-IP nature of this network allow it to be scaled very efficiently for growing usage, enabling it to support growing customer demand for high speeds and greater data consumption.

We have a defined programme of investment in the network to improve capacity and efficiency in line with the expected growth in demand for high speeds and data consumption. In FY16 we completed the first phase of our backhaul upgrade to deliver significant improvements in network performance for fibre customers. Over the next two years we will invest further in enhancing the capability of our next generation access and edge networks, which will reduce our costs to serve for all our customers, and drive significant further improvements in customer satisfaction. In addition we have designed the investments in the network to future proof three priority areas; the growth in fibre from FTTC to FTTP, the best Ethernet business network of choice, and mobile expansion. We expect these investments to fall within our capex envelope of 6%–7% of revenues.

Overall, as we continue to reduce the marginal cost of capacity of our network, we will be able to sustain a cost advantage that we can translate into compelling value for money propositions.

### FY17 guidance

**Revenue and EBITDA**

We expect FY17 revenues to grow modestly, driven by a broadly stable broadband base and continued growth in TalkTalk Business; and Headline EBITDA of £320m – £360m. Consistent with the trends seen in Q4, we expect to see Headline revenue decline in H12017, reflecting the smaller On-net base, and return to growth in H2 as comparatives ease.

In line with this, we expect EBITDA to reflect an H2 bias, with an H1:H2 weighting of broadly one third:two thirds.

**Net debt**

We expect Net debt/EBITDA to fall towards our target leverage of 2x by the end of FY17. With capex planned at 6%–7% of revenues and a material reduction in cash exceptional costs we expect year end net debt to be broadly similar to that at the end of FY16.

**Dividend**

We expect the FY17 dividend to be at least in line with that of FY16 and covered by free cash flow.

Dido Harding
**Chief Executive Officer**
12 May 2016

# Chief Financial Officer's statement

## Overview

We delivered FY16 Headline financial results in line with the guidance we gave at the time of the H1 results. FY revenue grew by 2.4% to £1,838m (FY15: £1,795) and Headline EBITDA by 6.1% to £260m (FY15: £245m). The Board has recommended a final dividend of 10.58p taking the total dividend for the year to 15.87p (FY15: 13.80p), in line with our commitment to grow the dividend by 15%. Net debt/EBITDA of 2.6x (FY15: 2.4x) was in line with the guidance set at H1.

H1 saw strong revenue growth (4.7%) but Headline EBITDA was impacted by increased operating costs related to our transformation projects, innovation and network investment. In H2 we delivered revenue growth of 0.2%, reflecting the impact on the customer base of the cyber attack in Q3, but strong progress in margins (H2 EBITDA margin 18.4%) helped by the benefits of MTTS coming through (£15m in addition to the £6m delivered in H1), and a significant reduction in SAC. In addition, operating metrics recovered strongly in Q4 with the customer base returning to stability, strong RGU growth and material churn reduction (1.3%, the lowest ever churn in our history). Exceptional items amounted to £83m for the year, of which £42m were related to the cyber attack. As a result of the strong improvement in profitability in H2, net debt/EBITDA at the year end of 2.6x, was, as guided, lower than the 2.8x at the end of H1.

The business has taken a number of key strategic decisions in the aftermath of the cyber attack which in addition to driving the recovery in Q4, have set us up for a robust performance in FY17, with further EBITDA growth expected.

## Financial information

| | 2016 £m | 2015 £m |
|---|---|---|
| On-net | 1,399 | 1,333 |
| Off-net | 55 | 87 |
| Corporate | 384 | 375 |
| **Headline revenue** | 1,838 | 1,795 |
| Gross profit | 993 | 980 |
| % | 54.0% | 54.6% |
| Operating expenses | (473) | (426) |
| SAC and Marketing | (260) | (309) |
| **Headline EBITDA** | 260 | 245 |
| % | 14.1% | 13.6% |
| Exceptional items | (83) | (46) |
| **Statutory EBITDA** | 177 | 199 |
| Depreciation and amortisation | (121) | (120) |
| Non-operating depreciation and amortisation | (10) | (17) |
| Share of results of joint ventures | (8) | (8) |
| **Operating profit** | 38 | 54 |
| Net finance costs | (24) | (22) |
| **Profit before taxation** | 14 | 32 |
| Taxation | (12) | 40 |
| **Profit after taxation** | 2 | 72 |

## Revenue

Total revenues grew by +2.4% to £1,838m (FY15: £1,795m), with H1 growth of 4.7% and H2 growth of 0.2%. H2 revenues were directly impacted by the cyber attack which resulted in a spike in churn and an extended period over which we were unable to trade from our online channels. The impact on Q4 revenues was more pronounced than in Q3 as we entered the quarter with a smaller customer base and it took longer than we had originally anticipated to fully restore our online channels.

On-net revenues grew by 5.0% to £1,399m (FY15: £1,333m). ARPU grew by +5.8% year on year driven by 3.9% growth in RGUs and pricing, offset by lower usage, mix and promotional activity.

Corporate revenues grew by 2.4% to £384m (FY15: £375m) against a strong prior year comparative (FY15: +10.3%). Data revenues continued to grow strongly (+23.7% year on year), driven by 9,000 new connections to our Ethernet and EFM base. Carrier revenues grew by 13.3% and as expected, moderated significantly in H2. The growth in data revenues and carrier helped offset the ongoing decline in legacy voice revenues (-16.2%).

Off-net revenues, which comprise less than 3% of total revenues (FY15: 4.8%), declined by 36.8% to £55m (FY15: £87m), impacted principally by the disposal of our consumer Off-net base at the beginning of year.

## Gross profit

Gross profit increased by 1.3% to £993m (FY15: £980m) with the gross margin rate falling from 54.6% to 54.0%. As expected we saw an improvement in the gross margin from H1 (53.4%) to H2 (54.5%), as some of the timing differences related to regular procurement benefits that depressed the H1 gross margin, reversed in H2. The movement in gross margin during the year reflects a number of effects: pricing activity and high margin data revenue growth, together with the benefits of disconnecting non-pay customers (c.£5m) and MTTS (c.£2m), were offset by the impact of higher than expected mobile data usage from our Unlimited SIM promotion in H1, continued reduction in voice revenues, and adverse mix.

## Operating expenses

Operating expenses were up by £47m over the prior year to £473m. The increase reflects a combination of our ongoing investment in innovation programmes (mobile, fibre to the premise and blinkbox: £13m); infrastructure, network and IT (£15m); and transformation costs of £31m (including MTTS, property related costs; and management overheads) offset by £12m of benefits from MTTS. Although year on year costs were up, we saw a significant reduction in opex from H1 to H2, of £17m, with transformation costs lower than H1 and a step up in MTTS benefits.

## SAC and Marketing

SAC and Marketing costs reduced by 15.9% in the year to £260m with H2 expenditure significantly lower than H1. The key drivers of the overall reduction in SAC were: reduced volumes in broadband and TV; lower costs per add in fibre year on year from the significant step-up in self-installation; a less SAC intensive mix in mobile compared to the prior year; and a much improved distribution channel mix. During H2, our focus on existing customers and the benefits of MTTS helped to reduce churn and enabled us to maintain a stable broadband base with fewer gross additions. This, together with the impact of more efficient distribution channels on costs per add, delivered a £31m reduction in SAC. In addition, we refocused marketing spend (£6m reduction) and saw a one-off reduction of £8m as a result of the disruption caused by the cyber attack.

## Headline EBITDA

Headline EBITDA increased by 6.1% to £260m (FY15: £245m) reflecting an EBITDA margin of 14.1% (FY15: 13.6%), driven by revenue growth, MTTS benefits and SAC efficiencies. The H2 margin of 18.4% was a significant improvement over H1 (9.9%), reflecting the H2 weighted delivery of MTTS benefits and SAC reduction.

## Exceptional items

The net exceptional charge in the year amounted to £83m (FY15: £46m) and comprises the costs incurred during Q3 FY16 in relation to the cyber attack, and one-off costs related to delivering the MTTS programme. The one-off exceptional costs associated with the cyber attack were £42m (FY15: nil) which includes the direct incident response costs and customer management costs including additional call centre agents, communication and marketing costs incurred during October and November; the costs of restoring our online capability with enhanced security features; and the increased retention costs including the cost of providing free upgrades to those customers who chose to take one. MTTS continued to gain momentum during the year delivering a further £21m of benefits and we expect to deliver a further £35m–£40m of savings in FY17. £41m of exceptional costs were incurred across these programmes as a result of improving customer experience systems and processes and implementing changes to the Group's organisational structure, exiting office locations and preparing for the move in April 2017 from our sites in Irlam and Warrington to a new single location at the Soapworks, Salford.

Cash exceptional costs of £88m (FY15: £30m) included a number of timing differences between the incurrence of the provision and the resulting cash outflow, most notably the timing of broadband base migrations which were provided for in FY15 but completed during FY16 and the provision in FY16 for cyber attack related technology costs and surplus property costs, which will be incurred in FY17 and beyond. Cash exceptional costs for FY17 are expected to be £30m–£35m.

## Depreciation and amortisation

Depreciation and amortisation expense was broadly flat year on year at £121m (FY15: £120m).

## Non-operating depreciation and amortisation

The amortisation of acquisition intangibles amounted to £10m (FY15: £12m) relating to the acquisitions of the Virgin Media and Tesco broadband bases and blinkbox in FY15. In the prior year, amortisation of acquisition intangibles included accelerated amortisation of £6m in relation to legacy software.

## Net finance costs

Net finance costs of £24m (FY15: £22m) comprised the blended interest rate of 3.07% (FY15: 3.00%) on higher levels of average net debt during the year. Finance costs in FY17 are expected to be in the range £26m–£28m.

# Chief Financial Officer's statement continued

### Profit before taxation

Profit before taxation decreased 56% year on year to £14m (FY15: £32m), reflecting the increase in exceptional costs offset by the increase in EBITDA.

### Taxation

The effective Headline rate in the year was 26% (FY15: 20%), representing a tax charge of £28m (FY15: £19m). The increased rate is due to the impact on the deferred tax asset of a reduction in the UK statutory corporation tax rate from 20% to 17% over the period from 1 April 2017 to 1 April 2020. In addition, a £2m tax charge has been recognised in exceptionals reflecting the impact of the same rate change on the deferred tax asset recognised through exceptional items in the prior year.

### Earnings per share

| | **2016** | 2015 |
|---|---|---|
| **Headline earnings (£m)** | 79 | 76 |
| Basic EPS | 8.4p | 8.2p |
| Diluted EPS | 8.3p | 8.1p |
| **Statutory earnings (£m)** | 2 | 72 |
| Basic EPS | 0.2p | 7.8p |
| Diluted EPS | 0.2p | 7.7p |

EPS on a Headline basis is provided alongside our statutory measures to allow easier comparison year on year, due to the impact of exceptional items. A full reconciliation to statutory results can be found in note 9 to the financial statements.

Headline EPS increased to 8.4p (FY15: 8.2p) driven by the increase in EBITDA, with the profile during the year showing significant improvement from 1.2p in H1 to 8.4p full year. The basic number of shares increased to 946m (FY15: 922m), driven by the ESOT share sale in H1. Statutory EPS decreased to 0.2p (FY15: 7.8p).

### Cash flow and net debt

| | **2016 £m** | 2015 £m |
|---|---|---|
| **Headline EBITDA** | 260 | 245 |
| Working capital | 10 | (19) |
| Capital expenditure | (166) | (112) |
| **Operating free cash flow** | 104 | 114 |
| Interest and taxation | (22) | (24) |
| **Free cash flow (pre-exceptional)** | 82 | 90 |
| Exceptional items | (88) | (30) |
| Acquisitions and disposals | (12) | (38) |
| Dividends | (135) | (116) |
| Sale of own shares | 63 | 2 |
| **Net cash flow** | (90) | (92) |
| Opening net debt | (589) | (497) |
| **Closing net debt** | (679) | (589) |

### Working capital

The working capital inflow of £10m in the year (FY15: £19m outflow) reflected a receipt in respect of the historic termination charge settlements with mobile network operators.

### Capital expenditure

As expected, capex of £166m (9% of revenues) in FY16 was higher than our long run average of 6%–7% (FY15: 6.2%) of revenues as a result of the phasing of our investment in innovation projects and some pulling forward of MTTS investment as a result of the cyber attack. This expenditure was focused on meeting the forecast demands for our network (higher capacity backhaul circuits); MTTS programmes; and innovation (e.g. hardware equipment for the Ultra Fibre Optic trial in York and the build of our new mobile billing system and associated functionalities).

We expect capex on our network, expenditure related to MTTS programmes and any further spend on completing the build of mobile billing systems to fall back to 6–7% of revenues in FY17.

### Interest and taxation

Interest paid in the year was £22m. No cash tax was paid in the year.

### Acquisitions and disposals

Acquisition expenditure in the year of £12m (FY15: £38m) mainly represents £8m in respect of the YouView joint venture (FY15: £8m), £1m in respect of the York FTTP joint venture (FY15: £3m) and £5m in respect of the initial consideration for tIPicall, offset by £2m received in relation to the disposal of the Off-net broadband customer base. During the prior year, the Group paid £29m in respect of the initial consideration for the Virgin Media Off-net broadband base and the Tesco broadband base, and blinkbox.

### Dividends

Dividends of £135m paid in the year (FY15: £116m) comprised the final dividend for FY15 9.20p and the interim dividend for FY16 of 5.29p.

The Board has declared a final dividend of 10.58p which will be paid on 3 August 2016, subject to approval at the AGM on 20 July 2016 for shareholders on the register 8 July 2016 (ex-dividend 7 July 2016). The total declared dividend for the year was 15.87p, a year on year increase of 15%, with dividend cover improving to 0.53x (FY15: 0.59x).

### Sale of own shares

The £61m inflow from the Employee Share Ownership Trust (ESOT) reflects a decision taken by the trustees of the ESOT to reassess the number of shares required to satisfy the ESOT's obligations under the Group's share award plans. The ESOT continues to hold 9.3 million shares (0.97% of total share capital). The remaining £2m relates to the in-year settlement of Group share schemes.

### Funding

The Group is financed through a combination of bank facilities and US private placement notes, retained profits and equity. Committed facilities at the year end totalled £944m (FY15: £819m) and further detail is given in note 18 to the financial statements. At 31 March 2016 £689m (FY15: £599m) had been drawn down under these facilities leaving £255m (FY15: £220m) of undrawn facilities. Covenants are substantially the same across all funding facilities and the Group was in compliance with its covenants throughout the current and prior year.

### Net debt and capital structure

Net debt in the year increased by £90m to £679m (FY15: £589m) driven by an increase in the dividend, exceptional costs and increased capex spend, offset by £61m proceeds from the sale of surplus shares in the ESOT. As a result the net debt to EBITDA ratio increased modestly from 2.4x at the end of FY15 to 2.6x at the end of FY16. The Board regularly reviews the capital structure of the Group and we expect leverage to fall towards our target of 2x by the end of FY17.

### Going concern

The Directors have acknowledged the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009', published by the FRC in October 2009.

Our business activities, together with the factors likely to affect our future development, performance and position are set out in the Business Review. Our financial position, cash and borrowing facilities are described within this Finance Review.

The breadth of our base, our value for money proposition, continuing improvements in operating efficiency and the largest unbundled network in the UK means that the Directors are confident in our ability to continue to compete effectively in the UK telecoms sector.

We have £944m of committed credit facilities and as at 31 March 2016 the headroom on these facilities was £255m. Our forecasts and projections, taking into account reasonably possible changes in trading performance, indicate that there is sufficient cash and covenant headroom on our facilities and that this, together with our market positioning, means that we are well placed to manage our business risks successfully and have adequate resources to continue in operational existence for the foreseeable future. The Directors have therefore adopted the going concern basis of accounting preparing the financial statements.

# Business model and strategy

**TalkTalk has consistently proved itself a challenger brand in the telecoms market. Throughout the Company's history, it has successfully harnessed critical customer and regulatory opportunities capable of giving it a sustainable cost advantage. TalkTalk has then used these effectively to democratise the telecoms sector, driving growth and uptake across its chosen markets. This strategy of pro-competition, positive disruption has paid dividends for the Company, which has delivered shareholder value over a sustained period.**

TalkTalk has grown rapidly in both scale and diversity of product and service offerings. It has driven both price and product innovation, whilst maintaining a strong position in its core consumer and business fixed telecoms markets through leveraging its sizeable customer base, network design and low cost operating structure. Over the last five years, TalkTalk has moved into the TV, mobile and fibre markets as well as expanding its range of high speed data products.

Central to TalkTalk's business model is the aim of being a great value for money provider. The Company keeps a relentless focus on saving customers money, whilst delivering an ever better customer experience through affordable, reliable, simple and fair products.

The October 2015 cyber attack was a major challenge for the business. However, it provided valuable insight and evidence that focusing on existing customers yields significant commercial and reputational benefits. As a result of the honesty and openness with which TalkTalk approached the data breach (including the offer of a free upgrade to all customers in recognition of their loyalty), trust in the brand has increased. Customers are now, on average, more willing to trust, and buy more products from TalkTalk, than they were before the attack.

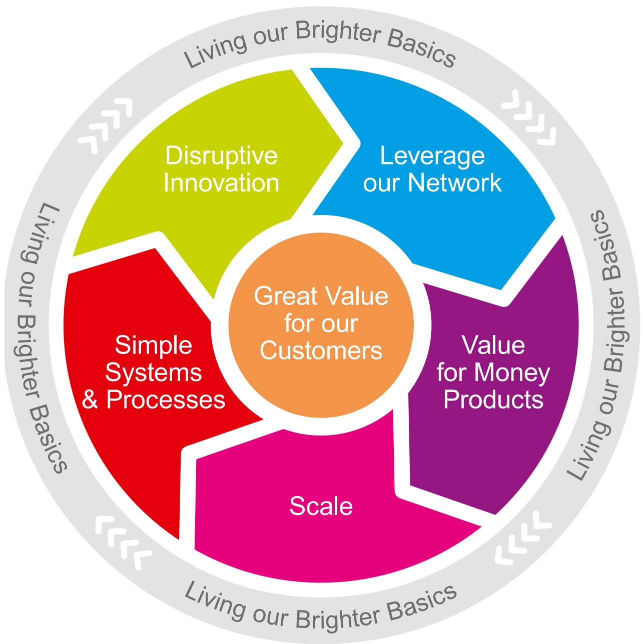
TalkTalk is more persuaded than ever that delivering on its commitment to being a great value for money challenger business will deliver sustainable growth and value. Through an ongoing focus on improving customer experience, already well established through the ongoing Making TalkTalk Simper programme, TalkTalk will continue to deliver meaningful improvements in customer satisfaction. The Company will look to simplify and clarify its product offerings, ensuring they are as competitive and customer friendly as possible. Customers have always saved money when they choose TalkTalk and the Company will continue to ensure that they always do.

Ten years ago, TalkTalk took advantage of changes in telecoms regulation which allowed the Company to price very competitively in the fixed market and therefore compete effectively against the high priced incumbents. This drove sizeable growth and value for the business. The market for high speed fibre (both superfast and ultrafast) is now growing rapidly, at the same time as technology and consumer behaviour between fixed and mobile networks begins to converge. As a result, the regulatory environment is evolving.

Ofcom is also looking to drive competition and investment into fibre to the premise (FTTP) and mobile through a combination of tougher regulation of Openreach, dark fibre products and access to poles and ducts. TalkTalk is already demonstrating both the considerable potential of FTTP (with its ultrafast joint venture in York), and the ability to bundle fixed and mobile products together as the market moves toward fixed/mobile convergence. TalkTalk will capitalise on its experience with local loop unbundling, as well as its proven credentials in price innovation, to ensure it is ideally placed to benefit as the market for next generation products continues to expand.

## Our strategy – the customer wheel

Our ambition is to be a great value for money quad play provider that consistently delivers **affordable, reliable, simple and fair** telecoms services for everyone.




See the People section on page 24 for further details on Living our Brighter Basics.

## Leveraging our network advantage

At the heart of the TalkTalk network is the unbundling equipment (digital subscriber line access multiplexers, multi-service access nodes and Ethernet switches) that we have installed in over 3,000 BT exchanges, covering c.96% of all UK homes – the largest such deployment in the UK. This structure allows us to take control of the copper line that connects customer premises to the exchange at a regulated price that has fallen over time. This gives us a sustainable cost advantage that we can translate into compelling value for money propositions.

The exchanges are connected via collector nodes that aggregate all of the 3,000+ exchanges and connect these to the core network. The equipment in these locations (a mixture of BT Openreach exchanges and our own data centres) is owned by TalkTalk. The nodes are connected by 10 Gigabits per second circuits to the core network for delivery of voice and data services. These circuits are either leased bandwidth or leased dark fibre.

Our dark fibre core optical network is the fundamental underlay of the network – a high speed, high capacity all-IP national backbone that enables efficient and flexible routing of voice and data traffic. The size and all-IP nature of this network allow it to be scaled very efficiently for growing usage, enabling it to support growing customer demand for high speeds and greater data consumption.

Access to the copper infrastructure that connects UK premises to BT's nationwide exchange footprint is price regulated by Ofcom, while fibre backhaul (the process of transporting data via exchanges to the Group's core network) and dark fibre (the Group's collector ring and core network) are leased on competitive terms from multiple providers. Access to BT's fibre to the cabinet (FTTC) (GEA) product, for on-sell to our customers, is provided by BT Openreach.

We have a defined programme of investment in the network to improve capacity and efficiency in line with the expected growth in demand for high speeds and data consumption. In FY16, we completed the first phase of our backhaul upgrade to deliver significant improvements in network performance for fibre customers. Over the next two years we will invest further in enhancing the capability of our next generation access and edge networks, which will reduce our costs to serve for all our customers, and drive significant further improvements in customer satisfaction. In addition, we have designed the investments in the network to future proof three priority areas: the growth in fibre from FTTC to FTTP; the best Ethernet business network of choice; and mobile expansion. We expect these investments to fall within our capex envelope of 6%–7% of revenues.

Overall, these investments will enable us to reduce the marginal cost of capacity of our network and further strengthen the economics of carrying traffic, especially data traffic.

## Value for money products

Our network confers a structural cost advantage that has enabled us to offer fixed line telephony, broadband and Ethernet connectivity at significantly lower retail prices than our competitors. Following the launch of fixed line phone and broadband services in 2006, we have leveraged our network and fixed line customer base by offering additional value for money services to consumers such as Internet Protocol television (IPTV), fibre to the cabinet and mobile. In addition, as we have designed our network for peak consumer traffic during the evening, we are able to leverage this capacity during the daytime for TalkTalk Business (TTB) which offers a wide range of connectivity products from phone and broadband to high speed Ethernet and generation voice to direct and wholesale B2B customers.

TalkTalk has consistently aimed to be a great value for money challenger brand, always striving to save its customers money and protect their best interests. This is still at the core of the Company's purpose and strategy, and has been soundly reinforced by the events of the last year. During the October 2015 cyber attack, TalkTalk was determined to look after its customers, ensuring the Company was open, honest and fair with them throughout. The success of this approach can be demonstrated in the strong response to TalkTalk's offer of a 'no strings attached' free upgrade for all customers (regardless of whether they had been affected by the cyber attack), as well as significantly reduced churn and improved trust in the brand since the attack.

Going forward, TalkTalk will build on these learnings to further strengthen the Company's reputation by championing customers' interests against the industry conventions. This approach was exemplified recently when the Company became the first provider to announce a shift to 'All-in Pricing'. This industry-leading move is supported by consumer groups, the regulator and the Government. All-in Pricing offers a radically simpler and more transparent approach for customers and typifies TalkTalk's continued efforts to put customers first.

# Business model and strategy continued

## Scale

Network capability, cost advantage and the ability to offer multiple value for money services has enabled us to build a large and sustainable share (c.16%) of the UK fixed line broadband market.

We have leveraged this position to drive penetration of TV (38% of phone and broadband base), mobile (19% of phone and broadband base) and fibre (19% of phone and broadband base). This quad play approach to driving revenue generating units aligns the Group's long term growth strategy of driving stable customer base, with the growing trend amongst UK consumers to save money by taking bundled products on top of their fixed line subscriptions. In time, we would expect the majority of our customers to be taking all four products, underpinning our scale growth opportunity.

TTB (a scale business, with revenues of over £500m per annum that have grown at over 6% compound over the last three years) has multiple further opportunities to grow in the fragmented B2B market. We plan, in time, to double its size by growing market share across all its product areas. TTB has leveraged the scale and reach of our network by offering a wide range of value for money, voice and data connectivity products to customers ranging from small office/home office businesses and small and medium sized enterprises to multi-site national enterprises. TTB is also one of only two network providers in the UK to offer wholesale phone and broadband, fibre and high speed Ethernet services across 96% of the UK. The acquisition of tIPcall in 2015 has added a significant new product capability to TTB in the form of B2B VOIP (SIP) (voice over internet), with powerful cross-selling opportunities.

## Simple systems and processes

Since the Demerger in 2010, we have delivered over £150m of cost savings through integration and simplification programmes. However, as a relatively young business that has grown rapidly, TalkTalk has a significant opportunity to further simplify its technology platform and customer processes to deliver a better and more secure customer experience.

Making TalkTalk Simpler (MTTS) is the Group's wide ranging transformation programme. MTTS is delivering material customer service improvements; driving operating cost savings; reducing subscriber acquisition costs; and ultimately, creating a simpler, more secure business and transformed brand reputation. Launched in FY13, these programmes are now fully embedded across our business operations and have delivered over £50m of savings to date. We have made significant progress in FY16: a comprehensive rebuilding of our online channels with enhanced security features; a significant improvement in network performance; improvements to order provisioning through case management; improvements in customer service through implementation of live chat and voice biometrics; and improved fault diagnosis and resolution, reducing engineering cost and unnecessary customer contact. With a further £35m–£40m of savings expected in FY17, savings beyond FY17 are expected to annualise at a substantially higher level.

Going forward, as a simpler, nimbler and more focused business than our competitors, TalkTalk expects to widen the cost advantage it holds, whilst continuing to improve customer experience.

## We are building on our price advantage to become a great value for money provider

**Clear price advantage** + **Better customer experience from Making TalkTalk Simpler** + **Clearer, more customer friendly bundles** = **Great value for money provider**

We have always had this

Customers have begun to see the improvements, more to come

Quad play attractive; simpler products to come

**Long term sustainable position**

## Disruptive innovation

TalkTalk has a strong heritage of launching innovative and disruptive products that leverage our network scale, engineering expertise and cost advantage, to give everyone access to new technology and, in doing so, saving customers money.

We were the first fixed line operator in the UK to offer:

- free fixed line calls between customers;
- free broadband;
- unlimited downloads to broadband customers;
- network level home internet security;
- a free TV product (on YouView, an integrated IPTV platform);
- business broadband at under £5 per month; and
- free nuisance and suspicious call blocking.

We see two major disruptive opportunities in the future. Firstly, a significant potential to build an integrated fixed and mobile network using our fixed line network and existing owned spectrum to drive down the costs of mobile. We are in the advanced stages of a femto cell testing programme that will lead to the roll-out of active cells in customers' homes from 2018. These indoor cells will allow mobile traffic to be offloaded onto the Group's fixed line network, thereby delivering a much improved indoor mobile experience and savings on the costs payable under the our mobile virtual network operator agreement with O2.

Secondly, we are making significant progress towards achieving our critical success factors (cost per home, customer experience and penetration) in Ultra Fibre Optic, our fibre to the premise (FTTP) trial in York, and are confident about the potential to roll out FTTP at scale. At a build cost of under £500 per premise passed and 30%–40% take-up, we believe it will be possible to build a c.10 million household network across the UK.

Both these innovations will allow us to deliver disruptive value for money propositions that leverage the economics of our fixed line network.

# Market opportunity

With over eight in ten households having broadband access, but a far smaller proportion taking bundled TV and mobile products, the UK market continues to offer growth opportunities. This is particularly the case at the value for money end of the market, both in underlying broadband connectivity and converged products. There is significant scope for growth amongst specific demographics: 20% of households remain offline, rising to nearly 50% of those aged 65 to 74 and two-thirds of those aged 75 and over (Ofcom). TalkTalk is well placed to compete and grow in this market environment as the leading value for money operator. The Company is consistently able to offer low prices across all products and bundles as a result of our scale, low operating cost model, fixed line network advantage and regulated access to BT's network.

There are four key players in the UK fixed line broadband and TV market. BT is the largest broadband service provider (32% share), followed by Sky (22% share), Virgin Media, the cable provider, is the third largest player (20% share) followed by TalkTalk (16% share).

BT and Virgin Media are positioned at the premium end of the connectivity market, with significantly higher price points than TalkTalk. They focus on speed and reliability of broadband connection. Sky's focus is on cross-selling broadband and voice products to protect and grow its premium pay TV base. BT also competes with Sky on pay TV content rights, specifically sports.

There are also four Mobile Network Operators (MNOs) in the UK mobile market: EE (29% share), O2 (29% share), Vodafone (23% share) and Three (12% share). In an increasingly convergent fixed-mobile market all four fixed line operators also offer or are about to launch, mobile services through MVNO agreements. TalkTalk is one of the most advanced quad play providers in the market with a 38% penetration of TV in its phone and broadband base, and 19% penetration of mobile. In addition to convergence, the UK market is also consolidating. Therefore, following its acquisition of EE, BT is now the UK's largest mobile operator.

In contrast to the consumer market, the fixed line business connectivity market is extremely fragmented with BT Group commanding a market share of over 50%, followed at some distance by Virgin Media and Vodafone. TTB's market share of less than 5% offers significant opportunity for growth through its position as the only alternative national wholesaler of broadband and fibre and Ethernet products.

# Regulatory environment

**The UK telecoms market is regulated by Ofcom which, amongst other objectives, sets the charges and other terms for wholesale access to infrastructure and associated services provided by BT, where BT is deemed to enjoy 'Significant Market Power'. Most of the wholesale products TalkTalk purchases from BT are provided by BT Openreach (BTOR). Ofcom's objective is to drive investment and to ensure that these wholesale products enable effective competition in the retail market, so that consumers and businesses benefit from a choice of attractive services and retail service providers. TalkTalk, along with other communication providers is required to comply with various regulation and legislation. TalkTalk's compliance with regulation is monitored internally by a Regulatory Compliance Committee.**

**Most material areas of regulation:**
TalkTalk relies upon a number of wholesale products from BTOR to be able to offer services to its customers. The key wholesale products are LLU (the copper connections into homes/businesses), GEA (access to BT's fibre to the cabinet (FTTC) network) and Ethernet (fibre links used to connect exchanges to the Company's core network and also to connect some Business customers). The price and terms of these are set by Ofcom though a triennial market review process which, particularly in the case of LLU, gives the Company reasonable certainty of future costs.

### Ofcom strategic review of digital communications

Following a consultation in July 2015, Ofcom published its 'initial conclusions' in February 2016. Though this did not set new regulation, it did provide a high level strategy that included: encouraging more FTTP investment by BT's rivals (through improving wholesale access to BT's ducts and poles); possible introduction of charge controls on GEA; increasing the separation between BT and BTOR (possibly including structural separation) to increase BTOR's independence; and a 'step change' in BTOR service quality. Many of these strategic changes will be implemented though the market reviews. The question of BTOR separation is being considered separately to the market reviews. Ofcom is expected to consult on proposals in summer 2016. Ofcom is assessing whether BTOR should be set up as a wholly owned subsidiary, though it is keeping open the option of structural separation which it considers may be the cleanest and most clear-cut long term solution. TalkTalk has been vocal in urging the regulator to take a bold approach, and the Government has recently called on Ofcom to 'take whatever action is needed to correct the competition problems identified, and to promote the growth of the digital economy, however radical a change that might be'. Whilst both legal and structural separation will reduce BT's ability to abuse its vertical integration (as accepted by Ofcom) and therefore benefit TalkTalk, we are clear that only structural separation can deliver the full benefits to the UK market.

### LLU charge control and service standards

In June 2014 Ofcom published its Fixed Access Market Review (FAMR), which included the new LLU charge control for the period to 31 March 2017: as a result MPF charges rose from £83.92 to £90.24. The FAMR also established new minimum service standards on BT for provisioning and repair of copper access lines, as well as a new requirement for BT to report a range of key performance indicators.

Ofcom is expected to begin consulting in autumn 2016 on the next LLU charge control which is due to be effective in April 2017. There is a material risk that the new charge control will not have been completed by Ofcom before the end of March 2017. Where this has occurred in the past, interim arrangements have been agreed between BT and Ofcom to ensure continued price controls. As a result of Ofcom's Cost Attribution Review which ended BT's practice of loading excessive costs onto regulated products, we expect MPF costs and therefore MPF charges to reduce in future.

### GEA charge control

BTOR provides wholesale access to its fibre infrastructure (predominantly FTTC), on an equivalent basis to all communication providers. The BTOR wholesale product is called GEA. TalkTalk uses GEA to provide its fibre broadband products. Whilst the price of GEA is not regulated, TalkTalk called for Ofcom to introduce margin squeeze regulation establishing the minimum margin between GEA and BT's retail price. In March 2015 Ofcom confirmed that margin squeeze regulation would come into effect from April 2015, with the first compliance report published in June 2015. Both BT and TalkTalk appealed the decision (on different grounds). The Competition Appeals Tribunal (CAT) dismissed certain aspects of BT's appeal. The Competition and Markets Authority (CMA) is considering TalkTalk's appeal and the remaining aspects of BT's appeal. A decision is expected in May 2016. Ofcom's FAMR will consider regulation of GEA from April 2017 onwards, including whether a charge control should be imposed and, if so, how it is calibrated. In May 2016, Ofcom published a consultation on its proposed approach to modelling the costs of GEA (to be used in the event that a charge control is applied). We expect some reduction in GEA prices as a result of Ofcom's market review.

### Duct and pole access

Ofcom set out in its Strategic Review that it would improve wholesale access to BT's ducts and poles so that BT's rivals could use these assets to roll-out their own FTTP networks. Ofcom will likely impose specific regulation on BT as part of its FAMR including: better information availability; a requirement on BT to use the wholesale products itself; and improved operational processes. Duct and pole access could benefit TalkTalk by reducing the cost and increasing the speed of roll-out of our own FTTP network.

**Business Connectivity Market Review**
In May 2016, Ofcom published the final statement of its Business Connectivity Market Review (BCMR) which sets regulation for dedicated fibre connections used by businesses, and as backhaul connections for LLU and mobile networks. The regulation included: price reductions averaging 40% over the next three years; minimum service standards for Ethernet circuits provisioning (where quality has been very poor for over three years); and an obligation for BT to offer a dark fibre access product to be launched by October 2017. The new regulation will benefit TalkTalk in several ways: lower costs for Ethernet services; the opportunity to lower costs further through using dark fibre; and an improvement in provisioning quality which will increase customer satisfaction.

**Wholesale Must Offer for sports channels**
Ofcom previously imposed a Wholesale Must Offer (WMO) obligation on Sky, requiring it to offer Sky Sports 1 and 2 on a wholesale basis to other retailers at regulated prices. In December 2015, Ofcom published a statement withdrawing the WMO obligation on Sky since it considered that it was no longer necessary, though it would reassess the need for regulation if supply did not continue to be provided on reasonable terms. This regulation does not directly affect TalkTalk since TalkTalk has commercial arrangements with Sky.

**Several other areas of current or potential regulation and legislation are significant for TalkTalk:**

**European Commission's Directorate General of Competition's (DG COMP) review of Three/O2**
DG COMP has been reviewing the proposed merger of Hutchison Whampoa and Telefónica's UK mobile businesses (Three and O2 respectively). The proposed consolidation would have reduced the number of MNOs competing in the UK market from four to three. DG COMP has now prohibited the proposed merger.

**Appeals framework**
The Government is currently considering legislative options for the second session of the 2015–2020 Parliament. Bills may include proposals to change the regime for challenging Ofcom's decisions through raising the hurdle for being permitted to make an appeal. This would reduce the time for Ofcom to finalise its decisions and make Ofcom more confident in setting strong regulation. TalkTalk is supportive of this proposal.

**European Commission Digital Single Market**
In May 2015, the European Commission published 16 initiatives as part of the Digital Single Market agenda. The measures seek to strengthen access to digital goods and services across Europe; improve regulatory frameworks; and strengthen digital growth by tackling issues such as skills shortages. The Commission is currently consulting on the proposals, with major changes unlikely to come into force before 2018.

**Investigatory Powers Bill**
In March 2016 the Government introduced the Investigatory Powers Bill, which seeks to consolidate and update existing legislation governing the retention and sharing of communications data. The Bill is subject to Parliamentary scrutiny and change, but is likely to extend the volume of data ISPs are required to store. TalkTalk is working with Government on the details of the legislation and how it would apply to the business. A version of the Bill is expected to be passed by Parliament by December 2016.

**Illegal file sharing**
TalkTalk, along with other major ISPs, has voluntarily agreed to send educational notifications to customers who have an IP address assigned to their account which has been detected as being used for illegal Peer to Peer (P2P) file sharing. The first notifications are expected to be sent around late 2016. Pursuant to various court orders, TalkTalk is required to block access to certain sites that are used for illegal file sharing and for trademark infringement.

**Voluntary measures on parental controls**
In June 2013, following a formal Government consultation into parental controls, the Prime Minister announced that the other three major ISPs would introduce whole home filtering systems – similar to TalkTalk's HomeSafe® service. He also announced that ISPs would ensure that all new and existing customers faced an unavoidable choice about whether to activate filters, which TalkTalk completed in 2015. The Government is expected to introduce secondary legislation in 2016 to support the existing system of parental controls. TalkTalk does not anticipate this impacting the business.

The Government is also currently consulting on additional measures to prevent children accessing pornographic content, with legislation expected this year. TalkTalk is working closely with the Government on these measures, which are not expected to include significant new responsibilities for ISPs.

Along with the other major ISPs, TalkTalk continues to support Internet Matters, a not-for-profit online child safety organisation. As a board member of the UK Council for Child Internet Safety, TalkTalk continues to engage actively with the Government on its policies for protecting children online.

**Switching**
Ofcom is consulting on proposals to reform switching of mobile communications services. It expects to publish its conclusions in autumn 2016. It is also continuing its work on switching of triple play services and is due to publish its next steps in summer 2016. TalkTalk continues to engage with Ofcom on these reforms. Government is currently considering legislative options for the second session of the 2015–2020 Parliament. Bills may include proposals to simplify switching. TalkTalk is supportive of a simpler, more customer friendly switching regime and is working closely with Government on the issue.

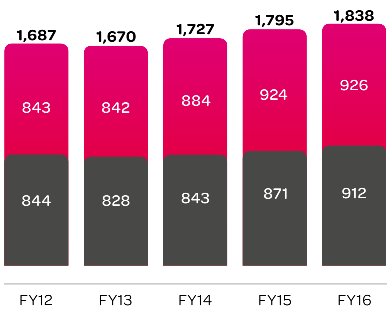
**Universal Service Obligation (USO)**
In November 2015, the Prime Minister announced an intention to introduce a broadband USO, with the ambition to give people the legal right to request a connection to broadband speeds of 10Mbps. Government is currently consulting on the legislative powers required and in March 2016 Ofcom launched a consultation on the USO design. TalkTalk is working closely with Government and Ofcom on the issue.

**EU roaming regulations**
In November 2015, the EU passed legislation on the maximum retail roaming surcharges that apply from 30 April 2016 and the removal of roaming surcharges from 15 June 2017. The Commission is reviewing the wholesale roaming market, fair use policies and sustainability mechanisms required to implement this policy. TalkTalk is engaging with the review and implementing the required changes to its roaming tariffs.

# Measuring our performance

## Financial metrics

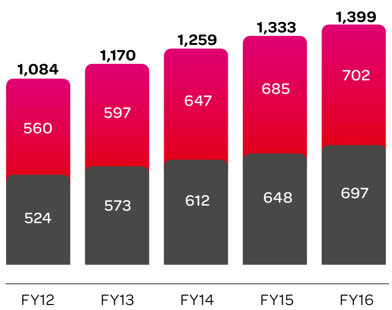
### Headline revenue
(£m)




**Definition**
Total Headline revenue across the business including On-net, Off-net and Corporate.

**Comment**
Total revenue was up 2.4% year on year, with H1 growth of 4.7% and H2 growth of 0.2%. H2 revenues were directly impacted by the cyber attack which resulted in a spike in churn and an extended period over which we were unable to trade from our online channels.

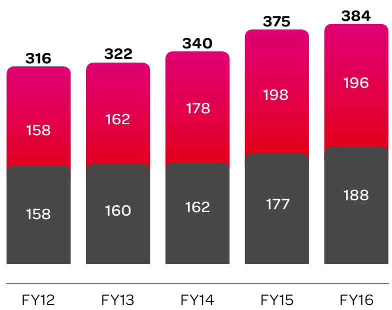
### On-net revenue
(£m)




**Definition**
Total revenue across our On-net products including On-net broadband, TV, mobile and fibre.

**Comment**
On-net revenues grew by 5.0% year on year. This was driven by ARPU growing by +5.8% year on year, as a result of +3.9% growth in RGUs and pricing, offset by lower voice usage, mix and promotional activity.

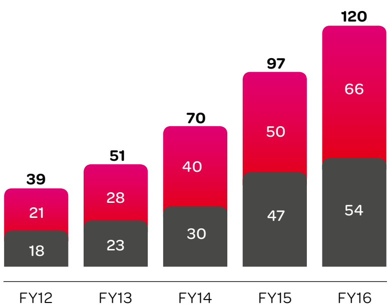
### Corporate revenue
(£m)




**Definition**
Revenue from our corporate products including voice, data and carrier services.

**Comment**
Corporate revenues grew by 2.4% year on year, driven by strong growth in data revenues, offsetting a decline in legacy voice revenues.

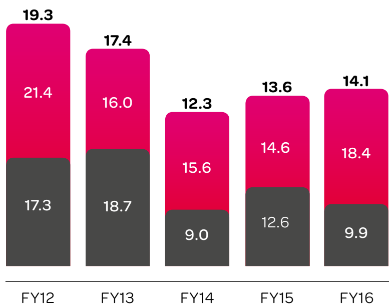
### Data revenue
(£m)




**Definition**
Revenues from our data products within TalkTalk Business.

**Comment**
Data revenues continued to grow strongly (+23.7% year on year), driven by 9,000 new connections to our Ethernet and EFM base.

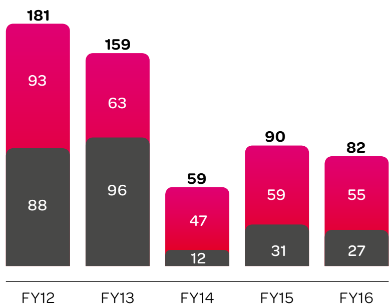
### Headline EBITDA margin
(%)




**Definition**
Headline EBITDA as a percentage of Headline revenue.

**Comment**
EBITDA margin grew to 14.1% in the year with a significant step up in H2 to 18.4%, driven by savings from MTTS and reduced SAC and Marketing costs.

### Free cash flow (pre-exceptional) (£m)



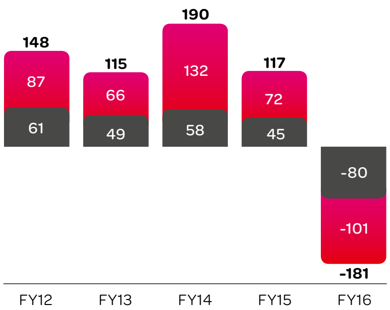

**Definition**
Cash generated after capital expenditure.

**Comment**
Free cash flow was down year on year driven by increased capital expenditure as a result of our focus on meeting the forecast demands for our network, MTTS programmes and innovation projects.

**Key:** H1 H2

# Non-financial metrics

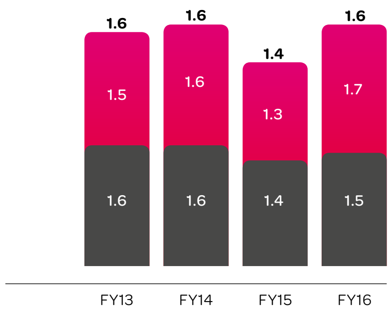
## Broadband net adds (On-net) ('000)




**Definition**
The net of new On-net broadband customers joining TalkTalk and those leaving TalkTalk.

**Comment**
Our On-net broadband base contracted in the year by 181k. A change in credit terms from 180 days to 90 days resulted in 72k non-paying customers being disconnected, and there was a 95k impact in Q3 from the cyber attack. The balance of the fall of 14k reflects underlying activity.

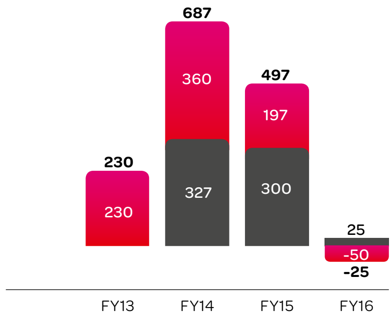
## On-net churn (%)




**Definition**
The percentage of our On-net customer base leaving TalkTalk each month.

**Comment**
While average churn across the year was 1.6% (including the cyber related churn), we saw a significant improvement in Q4 to 1.3%, representing our lowest ever quarter of churn.

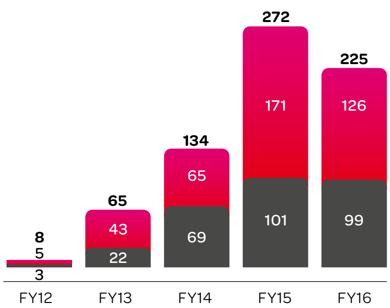
## TV net adds ('000)




**Definition**
The net of new customers joining TalkTalk TV and those leaving TalkTalk TV.

**Comment**
The TV base declined modestly during the year by 25k. With over a third of our base now taking TV, the product has been a remarkable success story for us in driving triple play growth with 1.4 million customers from launch four years ago.

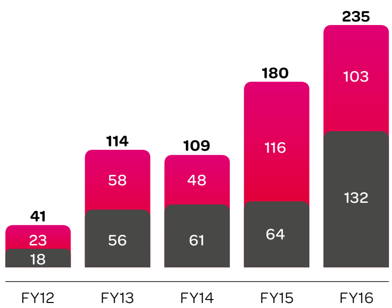
## Fibre net adds ('000)




**Definition**
The net of new customers connecting to fibre and those disconnecting from fibre.

**Comment**
We added 225k net new fibre customers during the year, taking the base to 704k, 19% of the broadband base compared to 13% a year ago.

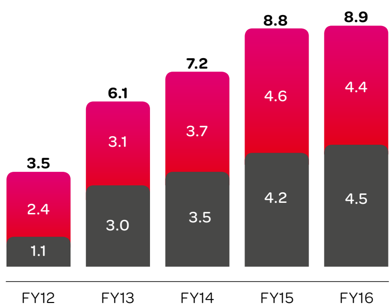
## Mobile net adds ('000)




**Definition**
The net of new customers connecting to mobile and those disconnecting from mobile.

**Comment**
The mobile base grew strongly in FY16 with 235k net adds taking the total base to 699k customers, 19% of the base compared to 12% a year ago. We saw strong take-up of bundled SIMs by our Plus TV customers, and further strong growth across our other value for money SIMs, including over the summer, our unlimited SIM.

## EFM and Ethernet net adds ('000)




**Definition**
The net of new customers connecting to data products and those disconnecting from data products.

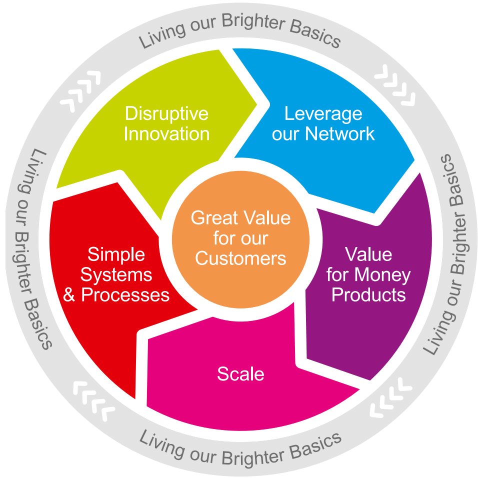
**Comment**
9,000 new high speed data lines connected in the year. Business demand for high speed data continues to remain very strong.

# Principal risks and uncertainties

**Every organisation faces risks of varying severity as an inherent part of doing business. Some of these are within the control of the organisation and others are not.**

The Board has identified the following principal risks and uncertainties to the Group, which the Group seeks to proactively manage and monitor on an ongoing basis. The detail of these principal risks, and the controls in place for mitigating them, are outlined below in no particular order of severity. The 'customer wheel' is used by TalkTalk to articulate its strategy. A link to the elements of our strategy has been included alongside each risk to highlight how the principal risk relates to the strategic objectives of the organisation. The highlighted sections of the customer wheel show the impacted areas. In addition, the directional arrows reflect the movements in 'gross risk' from the prior year.

The Group's risk management framework facilitates continuous and ongoing discussion of risks and associated risk appetite to ensure the appropriate focus is placed on mitigating principal risks. The Board will continue to assess the principal risks and uncertainties faced by the Group and will update the risk register and mitigation plans accordingly.




## Data and cyber security

### Risk and impact

Security of customer, commercial and colleague data poses increasing reputational and financial risk to all businesses. In particular, the sharp rise in cyber and data related crime presents a significant challenge in terms of securing data and systems against attack. Failure to do so successfully may have a material impact on brand reputation and financial performance. Other associated costs may also be incurred, including potential regulatory fines. As experienced by TalkTalk in October 2015, this is a modern, rapidly evolving threat requiring a new approach to risk which fully accounts for the scale and complexity of the ongoing challenge.

### Mitigation

The October 2016 cyber attack has had a significant and lasting impact on TalkTalk as an organisation. Prior to the attack, the Company was actively implementing an ongoing programme to build security capability. However, subsequent learnings have been fundamental in reshaping the Company's approach to risk and mitigation. Whilst it is not possible to completely eliminate data and cyber security risk, it is clear that effective mitigation must now go beyond building and operating security controls.

What is required is a sustained evolution of culture, organisation and ways of working which embeds security across the business.

TalkTalk will therefore continue the Ten Steps to Cyber Security programme, as well as maintaining and updating ongoing initiatives (such as monitoring activities, vulnerability scanning, penetration testing and the data loss prevention solution) to ensure they remain fit for purpose. However, following an extensive independent review of existing controls and processes, an updated security programme is also now in place, designed to ensure the business itself is optimally configured for security.

A number of other activities have been completed including:

- the realignment of Board-level responsibilities for technology and security, including the establishment of an additional senior position (Chief Information Security Officer) to support focus and oversight on the security plan and security activities; and
- the replacement of the previous governance forum for monitoring security progress with a Security Committee. This is a subcommittee of the Board, chaired by the Chief Executive, with senior executive representation and including a Non-Executive Board member.

In addition to the above, other activities are underway including:

- a comprehensive new governance structure to ensure sufficient security practices across systems, risk management, design, Company culture, third parties and internally;
- a thorough, high priority review of vulnerabilities of all systems and all data across the existing estate; and
- a renewed focus on awareness around data and cyber security, including formal internal and external awareness programmes.

### Link to strategy

### Gross risk

**Key:** Gross risk has increased   Gross risk has decreased   Gross risk remains broadly the same as prior year

## People

### Risk and impact

TalkTalk recognises employees as a key asset and aspires to be a 'Great Place to Work' for all colleagues. We understand the increasing challenges and importance in the market of attracting and retaining the right talent to deliver current performance and future growth aspirations. Failure to attract and retain required talent and competencies may negatively impact our ability to deliver on performance targets and strategic objectives.

TalkTalk has undertaken an extensive programme to understand and implement the behavioural and values-based changes required for the Company to evolve from a start-up culture to a fully mature, responsible business. Failure to successfully bring about this change may have a negative impact on the Company's reputational and commercial outlook.

### Mitigation

As well as a full internal review into corporate culture following the cyber attack, TalkTalk also appointed independent advisers PWC to conduct a thorough assessment of what happened and what learnings might be taken from TalkTalk's experience. Responding to these learnings, the Company is now implementing an extensive programme of cultural change, including behaviours, values and ways of working. More information on this is available in the 'People' section.

Structured talent forecasting and assessment processes are in place to ensure required talent is proactively understood. A people scorecard is also in place for ongoing monitoring and oversight of people risk and, where required, actions to further mitigate risk exposures are identified and implemented. In addition, a Group-wide engagement survey is completed annually to understand the level of employee engagement and action plans are developed from the survey to ensure a highly engaged and motivated workforce is maintained.

The Executive Committee assesses the annual engagement level of the workforce and, in addition, performs an annual assessment of talent at senior management level to ensure the right leadership is in place for motivating, inspiring and leading the workforce to deliver on the corporate objectives.

In FY16, TalkTalk announced the move to new office premises in Salford in 2017, reinforcing its commitment to developing a 'Great Place to Work' through investment in employees and their workplace.

### Link to strategy

### Gross risk

↑

## Customer trust and brand reputation

### Risk and impact

Customer confidence and trust are critical to TalkTalk's business, and the Company's operating approach always seeks to do what is right for the customer. However, as a value player in the market, there is a risk that TalkTalk is perceived as a 'budget' provider, associated with price rather than quality and service.

Events in the last twelve months have also had an impact on brand reputation and trust, particularly in the case of the Consumer business. Failure to maintain trust, improve brand reputation and offer a positive customer experience may result in increased churn, performance decline and loss of investor confidence.

### Mitigation

TalkTalk remains confident of the role for a well-regarded value champion in the market and is committed to delivering a positive end-to-end customer experience. The ongoing MTTS programme is designed to improve customer experience through better quality and availability of products and services. Over the last three years, the programme has delivered material improvements on congested exchanges and customer complaints handling processes, as well as improved web chat facilities, shorter call waiting times and router upgrades. Further significant benefits are scheduled for delivery in FY17. Programme progress and success is monitored via a formal governance structure, including senior management representation on the Steering Committee.

Building trust and confidence in a value brand presents particular challenges, particularly for TalkTalk's Consumer business. One of the key learnings from the October 2015 cyber attack was that putting customers first was critical to the speedy recovery of the business. Consistent quantitative and qualitative data suggests that the decision to inform customers, and to provide a gesture of thanks in the form of a free upgrade, has increased brand consideration and provided a firm foundation on which to improve trust and reputation. TalkTalk will now move forward with a renewed focus on existing customers, guided by the four key principles we believe are critical to being a value champion – affordability, reliability, simplicity and fairness.

### Link to strategy

### Gross risk

↑

# Principal risks and uncertainties continued

## Change delivery and execution

**Risk and impact**

Delivery of performance objectives and development of the business is reliant on the ability to successfully deliver innovation and other operational changes required to support growth and performance. Failure to effectively deliver change programmes and associated benefits, including MTTS, would result in an inability to deliver performance objectives and limit TalkTalk's competitive position in the market.

**Mitigation**

In FY16, TalkTalk formalised its change framework and established a centre of excellence Group Change function under the Group Change Director. The remit of the function includes overseeing and monitoring the progress of significant change programmes and embedding a consistent and robust change framework for delivery of change and innovation.

The Group Change function facilitates prioritisation discussions to ensure people and financial resources are appropriately engaged, allocated and focused. Performance measures for all key change projects are defined and monitored and benefit tracking is in place and regularly reviewed by Group Change. Monitoring and oversight of key change projects occurs at both the business unit leadership team level and by the Executive Committee on a regular basis. The Group Change Director sits on the Executive Committee, enabling real time consideration of the potential impact of other operational and strategic activities on current change projects.

**Link to strategy**

**Gross risk**

—

## Competitive intensity

**Risk and impact**

TalkTalk is established as a value for money provider in the fast growing quad play market. The value proposition is a key part of the business model and to date has provided competitor differentiation. Over the last year there has been significant activity in the competitive landscape. There is a risk that this competitive backdrop makes it difficult for TalkTalk to maintain its value credentials.

**Mitigation**

A clear pricing strategy is in place with ongoing monitoring of pricing position and value proposition. The strategy is reviewed to ensure it remains competitive and continues to support our position as a value for money provider against the changing competitor activity landscape. In addition, competitor pricing activity is monitored to understand customer and market impact and plans are revisited if necessary accordingly. TalkTalk uses customer communications to promote the value for money provider message and is committed to helping customers understand the best positioned package to meet their needs.

**Link to strategy**

**Gross risk**

↑

## Changing market structure

**Risk and impact**

The UK telecommunications market structure is currently experiencing significant change. Both the regulator and the Government have acknowledged a pressing need to promote competition and drive investment across the market, and TalkTalk is well placed participate in the opportunities that may result.

The outcomes from the Ofcom Strategic Review of the UK's digital communications markets (published in February 2016) fell short of recommending a formal split of Openreach from BT. However, mounting political and public pressure has led to Ofcom considering Openreach separation as part of a separate consultation process in summer 2016. The strategic review also included a commitment by Ofcom to help improve competition among broadband providers by opening up access to BT's infrastructure. The outcome of the review also included other proposals such as making it easier for consumers to switch providers.

There is a risk that change to the current regulatory regime of Openreach, and future mergers and/or acquisitions proceeding with limited or no remedies, creates a less competitive environment with possible negative impacts in the end customer.

**Mitigation**

TalkTalk has been a vocal advocate of competition and is well placed to benefit from an increasing trend toward a more pro-competition regulatory framework. This poses a significant risk to incumbent players in the market, whilst presenting potentially valuable opportunities for challengers. The business is actively engaging with the necessary external stakeholders to share views and attempt to deliver the best market and customer outcomes, as well as to proactively understand and respond to the opportunities and challenges presented by structured market changes.

**Link to strategy**

**Gross risk**

—

**Key:** ↑ Gross risk has increased ↓ Gross risk has decreased — Gross risk remains broadly the same as prior year

## Regulatory compliance

**Risk and impact**

The telecommunications sector is highly regulated, with compliance over key customer-focused regulations monitored by the governing body, Ofcom. The regulations that TalkTalk must comply with are designed to support customers. Failure to comply with regulatory obligations may result in negative customer impact and/or significant regulatory fines.

**Mitigation**

There has been continued focus on improving processes and controls and clarifying lines of accountability both in first-line operations and in our second-line assurance function. There has been significant progress with delivering improvements in our complaint handling processes during the period and there is continued focus on reducing compliant volumes. The Group's Regulatory Compliance Committee, a subcommittee of the Board, has continued to convene throughout the year to monitor the mitigation of operational risks which could give rise to customer complaints and regulatory breaches. The Group Counsel and Company Secretary has chaired weekly compliance meetings throughout the year, attended by senior management.

**Link to strategy**

**Gross risk**

## Financial

**Risk and impact**

A key financial risk is the ability to raise required short and long term funding to enable delivery of strategic objectives.

**Mitigation**

The Group Treasury function is responsible for managing the Group's liquid resources. Policies and operating procedures are in place and these are regularly reviewed to ensure they remain appropriate for the business. In addition, the Executive Committee and the Board oversee the liquidity and funding position of the Group on a regular basis and are required to provide approval on major and significant funding decisions.

**Link to strategy**

**Gross risk**

## Resilience and business continuity

**Risk and impact**

TalkTalk is reliant on its infrastructure as well as key third party suppliers and partners in order to deliver quality products and services to its customers. Network or third party failure could result in significant disruption to services or business processes, which may have a negative impact on customers and therefore damage customer loyalty or drive complaints. It is therefore important to establish resilience in the network and require resilience from our third parties and partners. It is also noted that in the event of an incident, TalkTalk must be able to respond in an efficient and effective manner in order to minimise impact on customers and performance.

**Mitigation**

Network resilience is assessed and monitored on regular basis and, over the last year, network improvements supporting greater resilience have been delivered. Further improvements are in progress and will continue in FY17. Continuous monitoring of network availability is also in place to ensure any issues are identified in a timely manner. Where an incident does occur, a robust incident response process is in place and exercised to ensure effective response in the event of an incident.

Other prioritised critical processes, systems and third parties are identified and business owners are assigned accountability for assessing resilience and implementing business continuity plans to enable continuity of operations in the event of an incident. For third parties, the relationship owners are assigned accountability for requiring critical third parties to have adequate business continuity plans in place and obtaining third party assurance that their plans have been reviewed and tested on a regular basis.

**Link to strategy**

**Gross risk**

# People

## TalkTalk has a unique culture founded on our 'Brighter Basics' and our mission to deliver **affordable, reliable, simple and fair** telecoms services for everyone.

**Customer**
We know our customers have a choice

**Innovate**
We zig when the world zags

**Value**
We always save our customers money

**People**
We can be ourselves here

**Community**
We know it's not just about the money

TalkTalk has been undergoing a wide ranging review of its corporate culture over the last year which has yielded valuable insights into our values, the way we work and the behaviours we role model. These are now being taken forward in an extensive cross-business programme of cultural change which will bring TalkTalk back to its roots as a great value champion.

### A more mature TalkTalk

To kick start our culture work, we required a clear view of our culture today. To source this, TalkTalk hosted a cross-Company event called a 'Culture Jam' where employees were asked four questions about the Company's culture, which they answered both on noticeboards across TalkTalk's sites and online. This was supplemented with 40+ workshops including over 300 employees and partners.

The Culture Jam presented a thorough and robust view of TalkTalk's culture today and has led to a suite of proposals for the development of our values, behaviours, leadership development and people processes to be implemented over the next year.

### Recovering from the cyber attack

The events of the cyber attack in October 2015 impacted every single employee at TalkTalk. To reassure and motivate colleagues through the first few weeks, the business shared daily updates with the whole Company, ensuring questions and concerns were addressed as honestly and speedily as possible. In November, the Company hosted mini 'All Hands' events at our three main sites hosted by our CEO and members of our Executive Committee. This was an opportunity to update colleagues on business performance face-to-face, to answer any outstanding questions and to publicly thank every employee for the part they played in taking care of our customers and stabilising the business. Throughout this challenging time, TalkTalk mirrored its approach of openness and honesty with customers with employees. As a result, TalkTalk staff were galvanised and united behind our overarching aim of protecting our customers.

Although the cyber attack itself was undoubtedly a challenging and sobering experience for TalkTalk employees, the business showed itself highly capable of maintaining morale, efficiency and co-ordination throughout a time of great uncertainty.

### Learnings from the cyber attack

As well as a full internal review into corporate culture following the cyber attack, TalkTalk also appointed independent advisers PWC to conduct a thorough assessment of what happened and what learnings might be taken from TalkTalk's experience. PWC's findings have been critical in helping to identify areas where improvement or change is required to ensure the Company's energetic start-up culture is underpinned by a fully mature, responsible set of corporate behaviours. Some of the key learnings from the report include:

- the need to see security not as a technology problem, but as a key element of every project, thus ensuring the whole business understands the risks and is able to make appropriate judgement calls between safety and business opportunity;
- the need to ensure security concerns are well communicated up and down the organisation. Security must be a consistently prominent and prioritised topic internally and colleagues must be kept up to date on policies, process and best practice; and
- the need to balance TalkTalk's fast-paced, entrepreneurial behaviours with an appropriate emphasis on governance and rigour.

The most important cultural learning for TalkTalk has been that effective cyber security goes deeper than simply improving our operating security controls. In fact it requires an evolution of corporate culture from start-up to fully mature business, in which reliability and responsibility are valued equally alongside innovation and 'can-do' attitude. Responding to these learnings, the Company is now implementing an extensive and exciting programme of cultural change, including behaviours, values and ways of working.

### Building A Great Place to Work

This year we have taken a new approach to measuring engagement at TalkTalk and participated in the Great Place to Work Institute's Best Workplaces Programme. This saw our employees participate in a survey to uncover how proud and satisfied they are feeling about working here. Participation was high, with 90% of our people taking part in the survey, and we had an engagement score of 71%, ahead of the engagement national average in the UK of 65%. This is particularly striking given that the survey was conducted in January 2016, just three months after the cyber attack took place.

Last year, the feedback from our engagement survey informed our Great Place to Work Priority, and we started a long term journey to focus on three key areas: Future Organisation – evolving our structure and making sure we have the right skills and capabilities for the future; Next Generation Working – creating a working environment that is frictionless, flexible and collaborative; and Culture – being clear about the values and behaviours we need to be successful. The journey will continue in the year ahead, but some of the highlights so far include:

**Future organisation:** the formation of a single Change Shared Service, working with new consistent processes and methodologies, as well as the formation of consolidated audit, risk and compliance; talent and development functions.

**Next Generation Working:** we opened our new meeting facility, The Boilerhouse in Salford, and announced that in 2017 we will be bringing employees from our two North West sites together into one new campus in Media City, Salford, called Soapworks. The site is being developed at the moment and will become a blueprint for all future TalkTalk sites, promoting collaboration and supporting a range of different working styles. We have also started to explore next generation working styles in our London office, moving away from fixed desks to more flexible team 'neighbourhoods' and hot desk spaces. These new working practices will be further enhanced in the year ahead, when we introduce Office 365 across the business, providing all TalkTalk employees with Microsoft desktop applications that are more secure, whilst enabling enhanced collaboration, communication and team working.

### Colleague performance and development

Career development remains a key driver of engagement at TalkTalk and this year we have made further improvements to our e-learning hub, TalkTalk U, ahead of a move later this year to a new Learning Management System, where we will be able to host an even wider range of interactive learning materials for our people. We also continue to offer our people mentoring and coaching sessions to support their development.

Our annual performance management process continues to drive achievement, with all employees participating in a performance related variable bonus pay scheme. This year we further aligned the process to our culture, evaluating employees on how well they have demonstrated our Company behaviours – the TalkTalk Essentials – as part of the performance management process. During their performance review this year, employees will now be partly evaluated not just on what they deliver but on how they deliver it, and their performance will be captured in our HR information system, Workday, for future traceability.

### Colleague benefits and share ownership

We continue to offer a comprehensive range of voluntary benefits, so employees can make choices to suit their lifestyle. We evaluate these on an annual basis, and this year we offered our employees even greater flexibility, with the ability to opt in and out of certain benefits throughout the year as their circumstances change. Our benefits not only drew praise from our people during our Culture Jam event, but have now also gained external recognition, as we received the award for 'Most Engaging Benefits Package' at the 2015 Employee Benefits Awards.

Share ownership remains an important part of our culture and over 65% of our people currently participate in our Sharesave and Share Match Schemes. Having so many of our people as shareholders creates great engagement and alignment with the interests of our investors. We believe in our employees being advocates for our products and continue to offer free home phone, broadband, fibre and TV to all employees, as well as half-price mobile packages and TV content offers throughout the course of the year.

### Colleague consultation – One Voice forum

One Voice is a consultation and information forum consisting of 80 nominated colleague representatives, management and members of our People Services team. The forum meets regularly to discuss how the key issues we face as a business might affect our employees, to share colleague feedback and discuss other relevant colleague matters.

### Colleague communications and events

We have a number of formal and informal channels that we use to keep our employees up to date, energised and engaged. Our online collaboration tool, The Wire, remains a critical communication tool for the business. The tool supports blogging at all levels of the organisation, so employees can continue to interact on Dido Harding's weekly blog, as well as regularly hearing from members of the senior management group and all their employees. The Wire proved an invaluable tool for us when we experienced the cyber attack last October. By means of daily blogs from Dido, we were able to provide employees with regular updates on the situation and ensure they were informed and able to raise questions and concerns.

A new innovation that we launched this year to further encourage use of The Wire was 'WeTalks' – open Q&A sessions hosted online, where employees can ask subject matter experts or senior management questions on a particular business topic. We provide all employees with an overview of all the key business news from The Wire every Friday, in an email publication called 'Re:Wired'. We also issue bi-weekly email communications to all People Managers with all the key information they need to support their teams.

For the past four years we have brought all of our UK-based employees and partners together for a one-day conference, All Hands, where we communicate our strategic priorities for the year ahead. This year, in May, we'll be hosting a roadshow-style version of the event, touring all of our sites in the UK and abroad. In the autumn, we also host an annual off-site festival called the Great Getaway, where employees and their families come together for a day of fun activities and musical acts as means of recognising contribution to the business.

### Colleague recognition

Celebrating employees who champion our culture is very important to us and we continue to recognise the individuals who are living our Brighter Basics through our On The Spot award scheme. Once a year at our All Hands event, we also recognise the 'Superheroes' amongst our employees and partners who have made an outstanding contribution to the business over the past year. Last year, 15 Superheroes were rewarded with trips to London, Manchester and York, where highlights included a dinner with members of our Executive Committee, a chance to see our Ultra Fibre Optic project come to life in York, and a VIP experience at Old Trafford.

At the end of last year, we specially recognised those employees who had gone above and beyond during the cyber attack and given up their personal time outside of work to help us through the crisis. We presented those involved with Red Letter Day vouchers, enabling them to choose a special treat for them and their families as a thank you for their support.

### Gender and diversity

Our people come from different backgrounds and cultures, creating a vibrant working environment that thrives on new ideas and fresh thinking.

The importance of diversity, equality and non-discrimination is highlighted in our Equality Policy and underpinned by our People Brighter Basic – 'We can be ourselves here' which guides the respectful way we behave towards each other. From our Great Place to Work survey we know that 80% of our people feel they can be themselves at work, which we believe gives us a competitive advantage. Furthermore, we scored 90% against the survey's diversity metrics around the fair treatment of our people. A breakdown by gender of the number of people who were Directors of the Company, senior managers and other employees as at 31 March 2016 is set out below:

| | Directors | Senior management | All employees |
|---|---|---|---|
| Female | 2 | 26 | 771 |
| Male | 10 | 73 | 1,461 |

# Corporate social responsibility

## At TalkTalk we want everyone to be able to enjoy the benefits of digital technology safely and securely.

We believe a civilised digital society is possible and we recognise we have an important role to play in helping to get there. For this reason, we focus our CSR efforts on three significant challenges: digital skills, digital safety and cyber security.

We want to unlock the potential of the digital revolution for the millions of people in the UK who still cannot benefit from increasing connectivity because they lack basic skills; we want to help parents keep their children safe as they spend more of their time online; and we want to fight the growing army of criminals looking to exploit society's increasing reliance on digital products and services through fraud and scams.

### Digital skills and inclusion

This year we strengthened our partnership with leading digital skills and training charity, the Tinder Foundation. Together we launched Internet Start, a subsidised TalkTalk broadband package exclusively available to learners attending Tinder Foundation's UK Online Centres and donated £30,000. For the fourth year running, hundreds of TalkTalk employees also volunteered as digital champions at participating local UK Online Centres, helping learners gain the vital digital skills needed to share in the benefits of the digital world.

As a founding partner of Go ON UK, TalkTalk pledged to work with Government to help make the UK the world's most digitally capable nation. This year we supported Go ON UK's 'Digital Skills Heatmap', an important research project to highlight areas of the UK where digital skills are lacking. We also worked with Go On UK to tackle the digital skills at local level in the London boroughs of Croydon and Lewisham, directing expertise, financial support and digital champion volunteers to various initiatives. In FY16, we donated £200,000 in total to the charity.

### Digital safety and security

TalkTalk understands that all ISPs play a very important role in helping to keep customers safe and secure online, and we are committed to doing what we can to protect them.

Since 2011 we have offered HomeSafe® to all our residential customers at no extra charge, enabling them to quickly and easily protect all the devices on a TalkTalk broadband connection. We also offer a similar service specifically for Business customers called WorkSafe, which is free with all Business Broadband and Superpowered Fibre Business Broadband services.

HomeSafe® has long allowed existing customers network-level filtering of the content they believe to be inappropriate for their families. In FY16, we asked all new customers to make an active choice about whether or not to switch on filtering services when they join us. We also remind customers about the service once a year, so that they can adjust their settings if their needs or usage has changed.

This year we extended our security measures, ensuring that our SuperSafe Boost is available free to all customers. Created with our long term security partner F-Secure, the upgraded Boost gives customers protection from viruses and malware, secure web browsing and additional security when banking or shopping online.

We have also joined forces with Get Safe Online, the UK's leading awareness resource helping to protect people, finances, devices and businesses from fraud. We made a £25,000 contribution in FY16 and we have begun to work with them on national consumer-focused campaign activities designed to change the behaviour of digital citizens, starting with our own customers, so they are less likely to fall victim to the growing army of online scammers.

We joined with the other four leading ISPs in 2014 to form Internet Matters, an independent not-for-profit organisation that provides information, support and advice to help parents keep their children safe online. This year we invested £500,000 in Internet Matters and generated £4m worth of in-kind marketing value by supporting awareness and information campaigns in communications.

### Additional activity

Since 2011 we have supported various projects, charities and individuals using digital technology at a local level to make a positive social impact. The TalkTalk Digital Heroes Foundation has enabled us to support our community initiatives, including the TalkTalk Digital Heroes Awards and our annual auction in aid of Ambitious about Autism.

The Digital Heroes Awards supports projects which harness technology to enhance lives and communities. This year, the judges awarded the £10,000 grand prize to Helen McCabe of HOME, a not-for-profit that helps individuals, local community groups and charities with their digital marketing. In total, TalkTalk awarded over £70,000 in grants and prizes.

A key fundraising vehicle for our charitable activity is our annual charity auction for Ambitious about Autism, now in its sixth year. Ambitious about Autism has had links with TalkTalk for 14 years, over which period we have raised £2m for the charity, with much having gone towards digital projects. In FY16 the auction raised £390,000 (FY15: £360,000).

Separately, TalkTalk has financially supported a number of other digital skills organisations with funding and promotion, including Apps for Good (£50,000) and Code Club (£30,000 per annum). We have also supported The Prince's Trust, with donations of £15,000 per annum since 2012.

This year TalkTalk also contributed £50,000 towards Founders Forum's inaugural 'F Factor' awards, a talent search backed by Charles Dunstone and Simon Cowell that offers a £10,000 prize to young technology entrepreneurs who pitch their business ideas to high-profile entrepreneurs.

Additionally, we donated £100,000 to ITV's 'Text Santa' appeal in aid of Macmillan Cancer Support, Make-A-Wish UK and Save the Children.

In total, the Group was responsible for generating £731,000 (FY15: £725,000) of income for registered charities, including £514,000 of direct cash donations (FY15: £340,800). The Group did not make any political donations in the current or prior year.

TalkTalk also retained both our FTSE4Good Index membership and Carbon Saver Gold Standard certification.

# Corporate governance

# Board of Directors and Executive Committee

## Board of Directors

PLC Board

| Sir Charles Dunstone, Chairman | | | | |
|---|---|---|---|---|
| Dido Harding, Chief Executive Officer | Iain Torrens, Chief Financial Officer | Tristia Harrison, Managing Director of TalkTalk Consumer | Charles Bligh, Managing Director of TalkTalk Business, Technology and Security | Tim Morris, General Counsel and Company Secretary |

Non-Executives

| | | | | | | |
|---|---|---|---|---|---|---|
| Ian West, Senior Independent Non-Executive Director | John Gildersleeve, Deputy Chairman | Brent Hoberman, Non-Executive Director | John Allwood, Non-Executive Director | Sir Howard Stringer, Non-Executive Director | James Powell, Non-Executive Director | Roger Taylor, Non-Executive Director |

### Chairman

**Sir Charles Dunstone**

Sir Charles is the founder of The Carphone Warehouse and created TalkTalk in 2002. He was appointed Chairman of TalkTalk in 2010. Sir Charles has directed the development of TalkTalk to become one of the leading fixed line telecommunication businesses in the UK. Sir Charles is Chairman of Royal Museums Greenwich, Land Rover BAR and Dixons Carphone PLC.

### Deputy Chairman

**John Gildersleeve**

John is Deputy Chairman, having joined the Board in January 2010. He is also currently Non-Executive Deputy Chairman and Senior Independent Director of Spire Healthcare PLC and Chairman of British Land.

### Executives

**Dido Harding, Baroness Harding of Winscombe**

Dido has been Chief Executive Officer of TalkTalk since February 2010. Prior to that, Dido was Sainsbury's Convenience Director, having been appointed to Sainsbury's operating board in March 2008. Dido joined Sainsbury's from Tesco PLC where she held a variety of senior roles. Dido is also a Non-Executive Member of the Court of the Bank of England, a member of the House of Lords and a Trustee of Doteveryone.

**Iain Torrens**

Iain was appointed Chief Financial Officer of TalkTalk Group in January 2015. Prior to joining TalkTalk, Iain served as Group Finance Director of ICAP plc between November 2010 and December 2014, having previously held a number of senior finance roles for ICAP plc, CP Ships Limited and Cookson Group plc. Iain is a fellow of the Institute of Chartered Accountants in Ireland.

**Tristia Harrison**

Tristia is the Managing Director of TalkTalk's Consumer business. Tristia joined The Carphone Warehouse Group in 2000 and has since held a number of senior management and executive positions in The Carphone Warehouse and TalkTalk Group. Tristia is also a Trustee at Comic Relief and national charity Ambitious about Autism.

**Charles Bligh**

Charles is the Managing Director of TalkTalk Business, Technology and Security having joined the Group in November 2011. During the year, Charles' role was extended to include accountability for Technology and Security. Previously Charles worked at IBM for 22 years where he held a number of senior executive and board roles working in large product and service businesses. Charles has worked internationally in Australia, the US, the UK and emerging markets in Asia. Charles is also a Trustee of the National Children's Orchestras of Great Britain.

## Non-Executives

**Ian West**
Ian joined the Board in February 2011 and is the Senior Independent Director. He has been involved in the TMT sector for over 25 years as a manager, director and investor. Ian held numerous roles at British Sky Broadcasting over eleven years, latterly as Managing Director of the Sky Digital subscription business. Ian is also currently an investor in a range of small and medium sized businesses and co-founded Top Up TV in 2003. Ian was a supervisory board member of Kabel Deutschland.

**Brent Hoberman CBE**
Brent is Chairman and co-founder of Founders Factory and the Founders Forum. Brent is Chairman and co-founder of made.com, he co-founded an early stage venture fund as well as co-founding lastminute.com in April 1998, which was sold in 2005. Brent is Chair and co-founder of Smartup and Intros.at. Brent sits on the advisory board for LetterOne Technology, the UK Government Digital Advisory Board and he is also a board member of The Economist. Brent is a YGL and Prime Minister's Business Trade Ambassador.

**John Allwood**
John joined the Board of TalkTalk in 2010 and is the Audit Committee Chairman. He has spent his entire career in media and telecoms holding a number of senior executive positions in these sectors, including Chief Executive of Orange UK between 2000 and 2004. Prior to that, John spent eight years at Mirror Group plc as Finance Director and Chief Executive. After leaving Orange he was Managing Director of Telegraph Media Group, and Chief Operating Officer and Finance Director of Mecom Group plc. In addition to his role at TalkTalk, he is Senior Non-Executive Director at IMI mobile plc, Chairman of Adgorithms plc and a Director of Creative Education Trust.

**Sir Howard Stringer**
Sir Howard joined the Board in July 2012. Until June 2013, he was Chairman of Sony Corporation, where previous appointments included President and CEO. Prior to Sony Corporation, Sir Howard had a distinguished 30 year career as a journalist, producer and executive at CBS Inc. as well as the Chairman and CEO of TELE-TV. In addition to his role at TalkTalk, Sir Howard is the Chairman of the American Film Institute, Said Business School, Oxford, and New York Presbyterian Ophthalmology Center, as well as being a board member of the BBC and Time Inc.

**James Powell**
James joined the Board in July 2012. James is Chief Technology Officer of Nielsen, having previously spent 14 years at Thomson Reuter as CTO. James held a number of senior leadership positions at Thomson Reuter, including CTO for Enterprise; CTO and Global Head of Product Development; Head of Technology Strategy; and CTO for the Thomson Reuter's financial division. He has also held senior leadership positions at Solace Systems, Citadel Investment Group and TIBCO Finance Technology.

**Roger Taylor**
Roger joined the Board as a Non-Executive Director in November 2015, having previously been TalkTalk's Non-Executive Deputy Chairman between January 2010 and July 2012. From 1999, Roger served over 16 years as CEO, CFO and Deputy Chairman of The Carphone Warehouse and Dixons Carphone PLC. Roger is also a founding Partner in both Student Castle LLP and Freston Ventures Investments LLP, which invests directly in a number of private businesses, including Five Guys Europe, MOD Pizza UK and Housesimple, in addition to various indirect private equity and investment funds.

## General Counsel and Company Secretary

**Tim Morris**
Tim is responsible for all legal matters including acquisitions, corporate governance and company secretarial matters at the Group. Previously he was a Partner at DLA Piper LLP.

# Executive Committee

**Dido Harding**
Chief Executive Officer

**Iain Torrens**
Chief Financial Officer

**Tristia Harrison**
Managing Director of TalkTalk Consumer

**Charles Bligh**
Managing Director of TalkTalk Business, Technology and Security

**Jeff Dodds**
Managing Director – mobile
(joined April 2016)

**Max Alexander**
Managing Director – TV
(resigned March 2016)

**Nigel Sullivan**
Group Human Resources Director

**Gary Steen**
Chief Technology Officer

**Tom Webber**
Group Change Director

**Tim Morris**
Group General Counsel
and Company Secretary

# Corporate governance

## Introduction

The Board is committed to the highest standards of corporate governance and, in accordance with the Listing Rules of the UK Listing Authority, the Board confirms that the Company has, throughout the year and as at the date of this Annual Report, complied with the provisions set out in the UK Corporate Governance Code (the 'Code').

This section of the Annual Report, together with the Strategic Report, provides details of how the Company has applied the principles and complied with the provisions of the Code and its five key principles: leadership, effectiveness, remuneration, accountability and relations with shareholders.

### Board balance and independence

The Board has twelve members, six of whom are considered independent Non-Executive Directors. These are John Gildersleeve (Deputy Chairman), Ian West (Senior Independent Non-Executive Director), John Allwood, Brent Hoberman, Sir Howard Stringer and James Powell. Roger Taylor, also a Non-Executive Director, is not considered to be independent given he was previously Chief Financial Officer of The Carphone Warehouse Group PLC from which the Company was demerged in March 2010, and was subsequently Deputy Chairman of the Company from January 2010 to July 2012.

Therefore, at least half of the Board (excluding the Chairman) are independent, notwithstanding the changes to the Board composition during the period.

During the year, the Board has overseen one change, which was the appointment of Roger Taylor to the Board as a Non-Executive Director on 11 November 2015.

The Chairman and Executive Directors have service contracts that can be terminated by either the Company or the Director on twelve months' notice.

The Non-Executive Directors are expected to serve for an initial period of three years, albeit either party may terminate the appointment on three months' notice with no compensation for loss of office. These initial three year periods commenced on 20 January 2010, with the following exceptions: Ian West (8 February 2011); Sir Howard Stringer (26 July 2012); James Powell (26 July 2012) and Roger Taylor (11 November 2015). After three years, the contracts automatically renew. All Directors in any event stand for re-election every year.

## Leadership

### How the Board operates

The Board has reserved certain matters, and delegated others to a committee of the Board. Day to day management rests with the Group's Executive Committee. Matters reserved for the Board include approving the Group's strategy, annual budgets and other longer-term planning.

### Board Committees

The Board has established the four principal committees below, to which it has delegated certain matters; the first three are as required by the Code, and the fourth is to ensure the compliance of the Group within the consumer regulatory environment in which it operates.

| Audit | Remuneration | Nomination | Compliance |
|---|---|---|---|
| John Allwood (Chair) | John Gildersleeve (Chair) | John Gildersleeve (Chair) | John Gildersleeve (Chair) |
| Ian West | Ian West | Ian West | Dido Harding |
| James Powell | Brent Hoberman | John Allwood | Tristia Harrison |
| | Roger Taylor(1) | Sir Howard Stringer | Charles Bligh |
| | | | Tim Morris |

(1) Roger Taylor was appointed to the Remuneration Committee on 11 January 2016.

The work of each Committee is described in more detail in the section relating to it below:

### Audit Committee

A detailed description of the Committee's remit and work during the period is contained in the Audit Committee Report on pages 34 to 36. Other Directors and senior management, including the Chief Financial Officer, the Company Secretary and advisers, attend by invitation of the Committee.

The Chairman of the Committee updates the Board following each Committee meeting.

The Committee's terms of reference, which are available on request from the Company Secretary and are published on the Group's website (www.talktalkgroup.com), comply with the Code.

### Remuneration Committee

A detailed description of the Committee's remit and work during the period is contained in the Directors' Remuneration Report on pages 37 to 55. Other Directors, including the Chief Executive Officer, the Company Secretary, the Group Human Resources Director and advisers, attend by invitation of the Committee.

The Chairman of the Committee updates the Board following each Committee meeting.

The Committee's terms of reference, which are available on request from the Company Secretary and are published on the Group's website (www.talktalkgroup.com), comply with the Code.

## Nomination Committee

The Committee is responsible for succession planning at Board level, overseeing the selection and appointment of Directors, regularly reviewing the structure, size and composition of the Board and making its recommendations to the Board. It assists in evaluating the commitments of individual Directors and the balance of skills, knowledge and experience on the Board.

The Committee has overseen the appointment of Roger Taylor as Non-Executive Director during the period.

The Chairman of the Committee updates the Board following each Committee meeting.

The Committee's terms of reference, which are available on request from the Company Secretary and are published on the Group's website (www.talktalkgroup.com), comply with the Code.

Other senior executives of the Group attend by invitation of the Committee.

## Compliance Committee

The purpose of the Committee is to provide the Board with visibility of how the Group remains compliant with those consumer regulations affecting its businesses from time to time. Its members therefore include those senior executives who are operationally responsible for implementing permanent changes necessary to ensure the Group remains compliant. Such members are accountable to the Committee and the Board for the successful delivery of such changes.

This Committee meets at least four times a year and reports to the Board accordingly. The Group also operates a weekly Compliance Committee made up of those senior executives responsible for all key areas of compliance across the Group. At these meetings relevant compliance is monitored against a weekly scorecard.

**Number of meetings attended**

| Director | Board | Audit | Remuneration | Nomination |
|---|---|---|---|---|
| Number of meetings | 7 | 3 | 4 | 1 |
| **Director** | | | | |
| Sir Charles Dunstone | 7/7 | | | |
| Dido Harding | 7/7 | | | |
| Iain Torrens | 7/7 | | | |
| Tristia Harrison | 7/7 | | | |
| Charles Bligh | 7/7 | | | |
| John Gildersleeve | 7/7 | | 4/4 | 1/1 |
| Ian West | 7/7 | 3/3 | 4/4 | 1/1 |
| Brent Hoberman(1) | 6/7 | | 3/4 | |
| John Allwood | 7/7 | 3/3 | | 1/1 |
| Sir Howard Stringer | 7/7 | | | 1/1 |
| James Powell | 7/7 | 3/3 | | |
| Roger Taylor | 2/2 | | 1/1 | |

(1) Brent Hoberman was unable to attend one Board meeting due to a prior arrangement.

As well as the formal meetings during the year, the Board met at other times as appropriate for specific matters, including approving certain announcements to shareholders.

It is important to the Board that Non-Executive Directors have the ability to influence and challenge appropriately. To this end all Non-Executive Directors are given a thorough induction to the Group and take part in Board discussions. All Directors receive papers in advance of meetings. They also receive regular reports and members of the Group's Executive team are invited to present at Board meetings and at the annual strategy meeting so that the Non-Executive Directors keep abreast of developments in the Group.

The Chairman meets regularly with the Non-Executive Directors, usually prior to every other Board meeting. This ensures that any concerns can be raised and discussed outside of formal Board meetings. The Senior Independent Non-Executive Director also attends these sessions where it is possible, if required, to discuss any matters with the other independent Non-Executive Directors.

The Senior Independent Non-Executive Director also takes responsibility for the performance evaluation of the Board; succession planning for the Chairman; and chairing Non-Executive Director only meetings. In addition, he is an alternative point of contact for shareholders in the event that normal executive channels are not appropriate. Details of the Senior Independent Non-Executive Director's role are set out on the Group's website (www.talktalkgroup.com).

# Corporate governance continued

### Operational management of the Group

The management of the Group's business activities is delegated to the Chief Executive Officer, who is ultimately responsible for establishing objectives and monitoring executive actions and performance through the Executive Committee.

The Chief Executive Officer chairs monthly meetings of the Executive Committee. Key responsibilities of the Committee, led by the Chief Executive Officer, are to:

- rigorously assess the Group's trading performance;
- identify and develop to a successful conclusion, those large-scale cross-Group projects which are critical to delivering the Group's strategy and maximises shareholder value; and
- provide a cross-functional forum for the discussion of opportunities and risks arising from business activities, as well as to communicate business performance.

### Performance evaluation and continued development

Each Board member has been subject to an internal performance review during the year, where the balance of skills, knowledge and experience of each Director was reviewed. This was undertaken by each member of the Board completing detailed questionnaires. Next year the Board will undertake an independent Board performance evaluation in compliance with its obligations every three years under provision B.6.2 of the Code.

The results were analysed by the Chairman, Senior Independent Non-Executive Director and the Board as a whole against the broad criteria of overall Board effectiveness and individual contributions. As part of the performance review the ability of each Director, in particular the Non-Executive Directors, to demonstrate the required time commitment to the role was assessed. As a result of this performance evaluation the Chairman confirms that each of the Directors seeking re-election at the AGM continues to be effective and has demonstrated the appropriate commitment to the role.

The Senior Independent Non-Executive Director also met with the other Non-Executive Directors to assess the Chairman's effectiveness during the year, taking into account the views of Executive Directors.

The Company Secretary ensures that the Board is made aware of new laws, regulations and other information appropriate to the Group to ensure that all Directors continually update their skills, knowledge and familiarity of the Group in order to fulfil their roles. Additionally, each Director has access to the advice and services of the Company Secretary and also has the ability to take independent external advice if required.

### Diversity

The Board understands the importance of having a diverse membership and recognises that diversity encompasses not only gender but also background and experience. The Board does not have a formal diversity policy and is generally opposed to the idea of stated quotas for females.

The equality policy applies equally to all appointments in the Company, and the Board believes that appointments should be made solely on merit, the key criterion being whether or not the appointee can add to or complement the existing range of skills and experience on the Board.

### Risk management and internal control

The Board views management of risk as integral to good business practice. The Company has established an ongoing risk management programme to identify, assess and mitigate business, financial, operational and compliance risks. The programme is designed to support management's decision making and to improve the reliability of business performance. The risk management process operates throughout the Group, being applied equally to the main business units and corporate functions.

The nature of risks identified and assessed are wide ranging, covering risks arising from the regulatory environment, strategy, counterparties and organisational change associated with major projects. Action plans and controls to mitigate identified risks are put in place where possible and if considered appropriate by the Board, taking account of costs and benefits. A report is provided to the Directors at relevant Board meetings setting out key risks, changes in the status of the key risks and updates on mitigation.

The Directors have overall responsibility for the Group's system of internal controls and for reviewing their effectiveness. The Board delegates to executive management the responsibility for designing, operating and monitoring these systems. The systems are based on a process of identifying, evaluating and managing key risks and include the risk management processes set out above and channels to enable employees to raise concerns about possible irregularities in financial reporting and other issues and associated processes for those matters to be investigated.

The systems of internal control are supported by the Business Assurance and Internal Audit function. Any significant risks identified in the year were given appropriate priority.

The systems of internal control are designed to manage, rather than eliminate, the risk of failure to achieve business objectives. They can only provide reasonable and not absolute assurance against material errors, losses, fraud or breaches of law and regulations. The effectiveness of these systems is periodically reviewed by the Audit Committee in accordance with the revised guidance in the Turnbull Report, including ensuring the external audit goes out to tender every ten years in line with the new EU regulations and directive on audit. These systems are also refined as necessary to meet changes in the Group's business and associated risks.

The Audit Committee also adopts an internal audit charter each year in accordance with International Internal Auditing Standards.

The systems of internal control were in place throughout the period and up to the date of approval of the Annual Report. The Board has conducted an annual review of the effectiveness of the systems of risk management and internal control in operation during the year and up to the date of the approval of the Annual Report. This was approved by the Audit Committee and the Board.

As outlined on page 20, learnings from the recent cyber attack have reshaped the Company's approach to information security risk management together with the assessment of our internal control environment. In accordance with the provisions of the Code, the Board acknowledge control weaknesses were identified following the recent cyber attack, however, the necessary priority mitigation has been implemented during the year. The Board will continue to ensure a sustained evolution of culture, organisation and ways of working which embeds security across the business.

**Relations with shareholders**

The Board believes it is important to explain business developments and financial results to the Company's shareholders and to understand any shareholder concerns. The principal communication media used to impart information to shareholders are news releases (including results announcements) and Company publications. In all such communications, care is taken to ensure that no inappropriate information is released.

The Chief Executive Officer and Chief Financial Officer have lead responsibility for investor relations. They are supported by an Investor Relations Director who, amongst other matters, organises presentations for analysts and institutional investors. There is a full programme of regular meetings and dialogue with major institutional shareholders, fund managers, analysts, retail brokers and credit investors, upon which the Chairman ensures the Board receives regular updates at Board meetings. The Board also receives periodic reports on investors' views of the performance of the Company. All the Non-Executive Directors and, in particular, the Chairman and Senior Independent Non-Executive Director are available to meet with major shareholders, if such meetings are required.

The Company plans also to communicate with shareholders through the AGM, at which the Chairman will give an account of the progress of the business over the last year, and a review of current issues, which provides the opportunity for shareholders to ask questions. The Company's AGM provides all shareholders with the opportunity to vote on the resolutions put to shareholders. Information relating to votes cast will, following the AGM, be available on the Company's website (www.talktalkgroup.com).

Further financial and business information is available on the Group's website (www.talktalkgroup.com).

**Viability statement**

In accordance with provision C.2.2 of the 2014 revision of the Code, the Directors have assessed the prospect of the Company over a longer period than the twelve months required by the 'Going Concern' provision. The Board conducted this review for a period of three years to March 2019. This assessment has been made taking into account the current financial position of the Group, the Group's business and financial plans and the principal risks and uncertainties faced by the Group, which are disclosed on pages 20 to 23 of the Strategic Report.

The Board reviews the internal controls and risk management policies and approves the governance structure and code of conduct as outlined on page 32 within the Corporate Governance section of the Annual Report. The focus is largely on improving the long term financial performance through becoming the UK's leading value for money quad play provider. Further detail of the Group's business model and strategy is outlined on pages 12 to 15 of the Strategic Report.

The three year review period has been stress tested by considering our existing strategy and the associated principal risks that underpin our current three year plan, which the Board reviews at least annually. The Board believes that a three year time horizon is most appropriate as it aligns with our normal and well established business planning processes. This analysis balances the long term nature of investment in the telecommunications industry with a realistic assessment of the variability of the key drivers of short term business performance, our strategy, as well as external factors and regulation impacting the Group. It also reflects our view on access to capital markets and other funding requirements. The assumption used within this analysis also includes consideration to the levels of operational performance, operational and capital expenditure cash flow requirements and our dividend policy.

Based on the results of this analysis, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over this three year period.

# Audit Committee

During the year, the Committee comprised the following independent Non-Executive Directors: John Allwood (Chairman), Ian West and James Powell.

The Chairman of the Committee updates the Board, following each Committee meeting, on any significant issues that may have arisen. In addition, the Chairman of the Committee is happy to make himself available to investors on request. During the year, all requirements of the Code in respect of the Committee were met.

The Group's Chief Financial Officer as well as representatives of the Company's external auditor and other members of senior management from Finance, Legal and Internal Audit and Risk also attend these meetings by invitation of the Committee or Chairman. The external and internal auditors have direct access to the Committee during formal meetings and time is set aside for them to have private discussion with the Committee, in the absence of management attendees.

John Allwood remains the member of the Committee with relevant and recent financial experience (as recognised by the Consultative Committee of Accountancy bodies), although all members are expected to be financially literate and have an understanding of:

- the principles of, contents of and developments in financial reporting, accounting standards and statements of recommended practice;
- key aspects of the Company's operations;
- matters that influence or distort the presentation of accounts and key financial information;
- the principles of, and developments in, key applicable company law and other legislation relevant to the Company;
- the role of internal and external auditing and risk management;
- the regulatory framework of the Company's business; and
- environmental and social responsibility best reporting practices.

During the year, the formal calendar of items considered at each Audit Committee meeting within the annual cycle encompassed the Code requirements to:

- monitor the integrity of the financial statements of the Company and reviewing significant financial reporting judgements contained in them;
- disclose the significant issues that the Committee considered in relation to the financial statements and how these issues were addressed;
- confirm that the consolidated financial statements, taken as a whole, are fair, balanced and understandable, to ensure that the narrative sections of the report are consistent with the financial statements and accurately reflect the Group's performance;
- review the Company's internal financial controls and its internal control and risk management systems and to make recommendations to the Board;
- review the Company's arrangements by which employees may raise concerns in confidence;
- monitor and review the effectiveness of the Company's internal audit function and review the output and findings of the internal audit team;
- make recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditor and to approve its remuneration and terms of engagement;
- review the Company's policy on the engagement of the external auditor to supply non-audit services;
- review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- disclose how the Committee has assessed the effectiveness of the external audit process and provide information on the length of tenure of the current audit firm; and
- review and approve changes to the Company's accounting policies.

The Committee's remit requires it to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and to make recommendations as to the steps to be taken.

### Significant judgements

The significant issues considered by the Audit Committee in the current year were as follows:

| Significant issue considered by the Committee | How the issue was addressed by the Committee |
|---|---|
| **The appropriateness of preparing the Group financial statements for the half year and full year on a going concern basis and the statement of viability** | The Committee considered and challenged papers and analysis prepared by management and, taking into account management's assumptions and the external auditor's review of these papers, concluded that management's recommendation to prepare the financial statements on a going concern basis is appropriate. The Committee considered and challenged management's approach to the viability statement, including the period of review and risk factors and concluded that the disclosure in the statement of viability is appropriate. |
| **The treatment of exceptional items and their presentation within the Group's financial statements** | The Committee considered and challenged management's approach and presentation of separately disclosed items. The Committee also considered and challenged the views of the external auditor on management's policy and its application during the year. At each meeting the Committee reviewed a paper prepared by management on actual and forecast levels of exceptional items, including the nature of all the items and the balance of income and cost between exceptional and Headline. The Audit Committee has reviewed and agreed the disclosure for inclusion in the consolidated financial statements.<br><br>In addition, the Audit Committee reviewed the Group's position in relation to the treatment of costs associated with the cyber attack, challenged management assumptions and agreed with the provision and classification made. |
| **Carrying value of goodwill and other intangibles** | The judgements exercised in relation to goodwill impairment testing concern the assumptions used in calculating the value in use of the cash generating units (CGU) being tested for impairment. The key assumptions applied in the calculation relate to the future performance expectations of the business, which are driven by the Group's calculation of its weighted average cost of capital (WACC) and its assessment of long term growth rates. The business plan used in the calculation has been approved by the Group's Executive Committee and the Board. The Committee reviewed and challenged management's paper on the outcome of the impairment review and agreed with the conclusion. |
| **Revenue recognition** | The key area of judgement in recognising revenue is the identification of revenue arrangements with multiple deliverables. When the Group sells a number of products within a bundled transaction, the total consideration from the arrangement is allocated to each element based on their relative fair values and limited to the amounts billed for that element. The Committee reviewed and challenged management's papers on the proposed accounting treatment for new products and customer credits and agreed with the conclusion. |
| **Supplier rebate income** | The Committee reviewed the level and application of the recognition policy of supplier rebate income during the year, an area of inherent risk due to the complexity of the arrangements and the judgement applied by management to ensure that rebates are recognised over the appropriate financial period. This review required an understanding of the nature of any significant transactions and adherence to the Group's accounting policies. As a result of the review, the Committee concluded that supplier rebate income had been appropriately recorded within the financial year. |
| **Taxation** | The key judgement in relation to taxation relates to the assumptions made in recognising deferred tax assets. The taxation forecasting model prepared by management has been approved by the Group's Executive Committee and the Board. The Committee reviewed and challenged management's paper, which outlines the key principles and judgements used in the calculation, and agreed with the recognition of the asset accordingly. |

# Audit Committee continued

**Statement of Directors in respect of the Annual Report and Accounts**

As required by the Code, the Directors confirm that the Annual Report and Accounts, taken as a whole, is fair balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy. When arriving at this position the Board was assisted by a number of processes including:

- the Annual Report and Accounts is drafted by appropriate senior employees across all areas of the business with overall supervision being provided by the Director of Group Finance, Tax and Treasury to ensure the report is consistent across all sections;
- a comprehensive verification process is undertaken to ensure the factual accuracy of the entire Annual Report;
- complete reviews of drafts of the report are undertaken by the Executive Directors and other members of the Group's Executive Committee; and
- the final draft is reviewed by the Audit Committee prior to final consideration by the Board.

**External audit**

The Committee is responsible for the development, implementation and monitoring of the Company's policy on external audit, which assigns responsibility for monitoring the independence, objectivity and compliance by the external auditor to the Committee.

Deloitte was appointed as auditor in 2010 when the Group demerged from Carphone Warehouse Group PLC. In the year to 31 March 2014, Sharon Thorne was appointed as the Senior Statutory Auditor. Deloitte has confirmed its independence to the Audit Committee. The Audit Committee considers the appointment of the external auditor annually and has a policy of formally tendering the audit every ten years.

In the year to 31 March 2016, the Audit Committee discussed the effectiveness of the external audit process and audit quality with the other attendees of the Audit Committee. Based on the results of the auditor assessment carried out in the year, the Audit Committee is satisfied with the effectiveness of the external audit process and quality. No actions are recommended. Following the FY16 audit, the auditor assessment will again be completed by each member of the Audit Committee, the Chief Financial Officer and other members of senior management who are invited to attend the Audit Committee meetings. The assessment covers all aspects of the audit process from the audit partner's interaction with the Audit Committee through to the planning and delivery of the audit. The feedback from this process will be considered by the Audit Committee and provided to both the auditor and to senior management. The results will be reviewed at the next Audit Committee meeting.

In light of the assessments and review undertaken, the Committee recommended to the Board that Deloitte LLP be retained as the auditor of the Company. This recommendation was endorsed by the Board. Deloitte LLP has expressed its willingness to continue in office as auditor and a resolution to re-appoint Deloitte LLP will be proposed at the forthcoming AGM.

The policy relating to the provision of non-audit services by the external auditor specifies the types of work from which the external auditor is excluded; for which the external auditor can be engaged without referral to the Committee; and for which a case by case decision is required. In order to safeguard the auditor's objectivity and independence, the ratio of non-audit fees to audit fees is monitored by the Committee. Any work proposed in excess of 50% of the audit fee is referred to the Committee. Amounts below this are discussed with the Chairman of the Committee.

A statement of fees paid or accrued for services from the external auditor during the period is set out below:

| | **2016 £m** | 2015 £m |
|---|---|---|
| Fees payable to the Company's auditor for the audit of the Company's Annual Report and Accounts | 0.1 | 0.1 |
| Audit of the Group and its subsidiaries pursuant to legislation | 0.4 | 0.4 |
| **Audit services provided to all Group companies** | 0.5 | 0.5 |
| Taxation and other services | 0.1 | 0.2 |
| **Total Group auditor's remuneration** | 0.6 | 0.7 |

During the year, the Group incurred non-audit fees of £0.1m for tax advisory services relating to HMRC enquiries. Having undertaken a review of the non-audit related work, the Committee has satisfied itself that the services undertaken during the year did not prejudice the external auditor's independence.

**John Allwood**
**Audit Committee Chairman**
12 May 2016

# Directors' Remuneration Report

## On behalf of the Board, I am pleased to present the Directors' Remuneration Report for FY16 in TalkTalk Telecom Group PLC's sixth year as a publicly listed company.

**Introduction**

In line with the Large and Medium-sized Companies and Group (Accounts and Reports) (Amendment) Regulations 2013 ('the Regulations'), the Remuneration Report for the year ended 31 March 2016 is split into two sections:

- The Remuneration Policy, which sets out the Company's policy on remuneration for Executive Directors. The policy was accepted by shareholders by a binding vote at the 2014 AGM and is now effective for three years from this date. There have been no amendments to the Remuneration Policy in the year ended 31 March 2016 and the unchanged policy will remain in effect for the year ending 31 March 2017.
- The Annual Report on Remuneration, which explains how the Remuneration Policy was applied in relation to Executive Directors for the year ended 31 March 2016 and how it will be implemented for the year ending 31 March 2017.

**Aligning the Remuneration Policy with Company strategy and performance**

The Remuneration Committee understands the importance of linking the Remuneration Policy and approach to business strategy and this focus has continued over the past twelve months.

The Group's remuneration approach applies throughout the Company and continues to be focused on enabling it to attract, motivate and retain high quality talent and ensuring there is a transparent link between remuneration and strategy at all levels, as well as the long term performance of the Company.

**Board changes during FY16**

**Board resignations**

There have been no resignations from the Board in the year ending 31 March 2016.

**Board appointments**

Roger Taylor was appointed to the Board as a Non-Executive Director effective from 11 November 2015. Fees were set by the Remuneration Committee in line with our pay policy.

**Remuneration Policy during FY16**

In the year ending 31 March 2016 and in line with the binding shareholder vote at the 2014 AGM, the Remuneration Committee has reviewed the Remuneration Policy for Executive Directors and has determined that it continues to remain appropriate and fit for purpose. All remuneration arrangements for Executive Directors and Non-Executive Directors have been operated in line with the shareholder-approved Remuneration Policy.

Performance against the Annual Bonus scheme targets would have resulted in a scheme pay-out of 62.4% of base pay for the Executive Directors. Whilst this would have been significantly lower than the previous years' pay-out of 80.5%, in the context of the cyber attack on TalkTalk and after careful consideration, the Remuneration Committee has exercised its discretion and determined that the annual bonus should be at a reduced level of 40% of base pay to reflect those events. Achievement against the measures set is shown on page 47 of the report.

In line with new Tapered Annual Allowance changes relating to pension contributions, which came into force from April 2016, the Company has written individually to all employees, including Executive Directors, who currently participate in the pension scheme, who it believes may be impacted by such a change. The Committee does not propose to change any of the current pension arrangements in response to the introduction of the Tapered Annual Allowance.

**Remuneration Policy for FY17**

The Group strives to achieve its objectives of a simple and transparent approach to remuneration. The Remuneration Policy is set out on pages 39 to 45 and details of how this policy will be implemented for the financial year ahead are set out on pages 46 to 55, with the following key changes being highlighted:

- confirmation of our intention to retrospectively disclose targets and achievement against targets for the Annual Bonus plan, two years in arrears;
- to make further awards under the Shareholder Value Plan (SVP) to members of our senior leadership team; and
- intention to review and update the Remuneration Policy ahead of a new binding shareholder vote at the July 2017 AGM.

**John Gildersleeve**
**Remuneration Committee Chairman**
12 May 2016

# Directors' Remuneration Report continued

**Highlights of FY16**

- No changes have been made to the Remuneration Policy during the year ended 31 March 2016.
- We have reviewed the Directors' Remuneration Report in line with the Regulations, to ensure that it continues to be simple and transparent for our shareholders.
- The Company has determined that bonus targets and performance against these targets should be retrospectively disclosed two years in arrears. Targets and performance against these targets are therefore included in this report in relation to the bonus scheme for the year ending 31 March 2014.
- It was determined that in relation to the Discretionary Share Option Plan (DSOP) award made in 2012, the Total Shareholder Return performance condition had met its super stretch target, with the earnings per share minimum threshold being missed, which resulted in 50% of the award vesting in May 2015. 60% of the vested options were immediately available to exercise in May 2015 and the remaining 40% of the vested option will be available to exercise from May 2016.
- The Company was proud to win Employee Benefits' 'Most Engaging Benefits Package' in June 2015.

**Our priorities for FY17**

- To review the performance metrics for our short term incentive plans to ensure they remain aligned with both shareholder interests and the strategic growth plans of the Company.
- Launch the 2016 Sharesave Scheme to further encourage employee share ownership. Employee Share ownership currently stands at 66%.
- To make further awards under the Shareholder Value Plan (SVP) to members of our senior leadership team.
- Our continued commitment that no employee of the Company will be paid below the Alternative Living Wage for the year ending 31 March 2017.

**The current regulations require the Company's auditor to report to the members on the 'auditable part' of this report (marked *) and to state, in its opinion, that this part of the report has been properly prepared in accordance with the Companies Act.**

## Remuneration Policy

**This section sets out the Company's policy on remuneration for Executive Directors. Following approval by shareholders and the binding vote at the 2014 AGM, the Remuneration Policy took immediate effect following the AGM and will apply for a period of three years from this date. There has been no change to the Remuneration Policy following shareholder approval in 2014. The Policy is restated below for reference purposes, with minor amendments (such as references to page numbers), for ease of reading. The definitive version of the 2014 Policy is available for review on the Company's website.**

### Remuneration Committee

The Remuneration Committee is responsible for making recommendations to the Board in relation to the individual remuneration packages for the Executive Directors and the Chairman. These recommendations comply with the Remuneration Policy, which is set by the Board, and the terms of reference of the Committee. The Committee works with the Board to determine the balance of allocation of profits between employee incentives, shareholder dividends and reinvestment into the Group.

### Remuneration approach

The aim of the Remuneration Policy is to support the Group in:

- aligning individual and business performance with the interests of shareholders through the delivery of clear and stretching targets;
- strengthening the link between employee output and the delivery of shareholder value;
- supporting the Group's overarching philosophy, to maintain its 'value player' positioning in the marketplace;
- attracting, motivating and retaining high quality talent;
- maintaining a stable, efficient cost base;
- enabling the Group's remuneration strategy to be tailored to its changing circumstances; and
- reflecting corporate governance best practice.

The Company firmly believes that remuneration should be structured in a fair and competitive way, in order to incentivise individuals to achieve the highest levels of performance, and takes a consistent approach throughout the Group.

Packages are designed to be market competitive with fixed remuneration set at market median levels. Variable rewards, which are linked to challenging objectives based on the performance of the Group, are designed to reward exceptional performance and for the delivery of shareholder value creation.

### Employee and shareholder consultation

The Remuneration Committee did not formally consult with employees of the Company on the details of the Directors' Remuneration Policy in the year ended 31 March 2014 when reviewing in line with the new Regulations. In reaching this decision the Committee is mindful that with the Company's strong culture of employee share ownership, with over 65% of employees holding shares in the Company, employees have the opportunity to comment and vote on all elements of this report and policy in their capacity as shareholders. Employees are also given the opportunity to share their views through regular employee surveys and the all-employee consultation body 'One Voice'.

The Remuneration Committee is committed to consultation with major shareholders when setting the Remuneration Policy. If any of these shareholders are opposed to the policy or any proposed amendments to the policy, the Committee will endeavour to meet with them, as appropriate, to understand and respond to any issues they may have.

### Remuneration components

We define our main fixed and performance related elements of remuneration as follows:

- base pay, car allowance, benefits and pension contribution (fixed); and
- annual performance bonus (variable).

In addition, for Executive Directors, Executive Committee members and other key senior management, there are two long term incentive plans – the Discretionary Share Option Plan (DSOP) and the Shareholder Value Plan (SVP), operating under the rules of the Value Enhancement Scheme (VES). These plans do not run concurrently.

The SVP is an alternative reward mechanism for Executive Directors and other members of the senior leadership team who will not participate in the DSOP. The Remuneration Committee intends that, generally, in any one year, participants may only receive an award under the SVP and no other long term incentive plan.

The Committee reviews, at least on an annual basis, pay-out levels for Executive Directors at minimum, 'on target', 'stretch' and 'super stretch' levels of performance, in order to ensure alignment with our shareholders.

# Directors' Remuneration Report continued

## Remuneration Policy continued

### Malus and clawback

The rules of the annual performance bonus and long term incentive plans allow the Remuneration Committee to exercise its discretion in using malus or clawback provisions, should it feel that it is in the best interests of the Company and its shareholders. The Committee's policy on the exercise of its discretion is set out in this Remuneration Policy. All future long term incentive awards will be subject to malus and clawback provisions, although no such awards have been made to Executive Directors in the year ending 31 March 2016.

### Executive Director shareholding requirement

To ensure that the interests of the Executive Directors are closely aligned to those of its shareholders, the Company requires Executive Directors to build over a number of years and retain a shareholding in the Company of at least 200% of their annual base pay.

For the purpose of this requirement the Company requires these to be in unfettered and beneficially owned shares. Newly appointed Executive Directors are given the opportunity to build up their shareholding over a period of years.

### Summary of remuneration components of Executive Directors

| Component | Aim and link to strategy | Description of operation and any performance measures | Further detail on maximum opportunity and framework used to assess performance |
|---|---|---|---|
| **Fixed**<br>Base pay | To attract and retain talent by ensuring base pay is competitive in the market.<br>Set at a level which incentivises Executive Directors to implement and deliver our business strategy. | Paid monthly in cash. | Reviewed annually.<br>Benchmarked against external market data from external specialists.<br>Takes into account the individual's skills, experience and performance.<br>The Remuneration Committee considers the level of the all-employee pay review when making recommendations and decisions on pay for Executive Directors.<br>Any increase typically takes effect from 1 July annually.<br>Under normal circumstances no Executive Director will receive an increase in excess of 10% of their base pay in any given financial year. |
| **Fixed**<br>Core benefits | Designed to be competitive in the market. | Core benefits typically include:<br>• a defined contribution pension scheme, or a cash payment in lieu of a pension contribution in certain circumstances;<br>• private medical insurance for Executive Directors and their immediate family; and<br>• car allowance/company car.<br>Executive Directors are also entitled to participate on the same terms as all other employees in respect of the following benefits:<br>• four times base pay life assurance;<br>• income protection; and<br>• annual leave. | Reviewed annually relative to the market.<br>Pension contributions are made through salary sacrifice, with the Company making a contribution of 10% of base pay for the CEO and CFO, which is made as a cash payment in lieu of pension, and 5% base pay for all other Executive Directors.<br>If cash is paid in lieu of a pension contribution this will be subject to normal tax and NI deductions.<br>Although the levels of Company contributions vary, all employees have the ability to join the Company's defined contribution pension scheme. |

## Summary of remuneration components of Executive Directors continued

| Component | Aim and link to strategy | Description of operation and any performance measures | Further detail on maximum opportunity and framework used to assess performance |
|---|---|---|---|
| **Fixed**<br>Voluntary benefits | Benefits may vary dependent on the role of the individual and the personal choices they make. | These voluntary benefits arrangements include the purchase of additional holiday and the ability to participate in all-employee share plans. | Reviewed periodically relative to the market. |
| **Variable**<br>Annual performance bonus | Designed to focus Executives on the business priorities for the financial year ahead and to align the individual's remuneration with the delivery of superior business performance. | The bonus scheme is based on a 'balanced scorecard' that is comprised of financial and non-financial measures, which are reviewed annually. Such measures include Group EBITDA, Group revenue and innovation measures.<br>The measures and targets are set annually by the Remuneration Committee to ensure they are appropriately stretching for the delivery of 'on target', 'stretch' and 'super stretch' performance.<br>At least 40% of the 'balanced scorecard' will be based on financial measures. | Payment is typically made in June.<br>The Remuneration Committee retains the ability to exercise discretion to adjust payments up or down in exceptional circumstances where they feel this course of action is appropriate.<br>The bonus scheme pays at the following levels:<br>• on target awards for Executive Directors are equivalent to 60% of base pay;<br>• stretch awards for Executive Directors are equivalent to 110% of base pay; and<br>• super stretch (maximum) awards are equivalent to 170% of base pay. |
| **Variable**<br>Share-based incentive plans<br>Discretionary Share Option Plan (DSOP) | Designed to reward and retain Executives over the longer term whilst aligning an individual's interests with those of shareholders. | Discretionary awards of nil-cost options are granted over TalkTalk Telecom Group PLC shares.<br>Level of vesting is dependent on achievement of performance targets, usually over a three year performance period from the date of grant.<br>For awards up to 2013, the performance measures were 50% EPS and 50% TSR. In 2014 and 2015, the performance measure was a TSR CAGR measure with a FTSE 250 tracker underpin.<br>Awards vest after three years from grant. 60% of the total vested options are exercisable in the third year, with the remaining 40% being eligible for exercise from the fourth year.<br>There is no intention to award DSOP awards to those Executive Directors participating in the Shareholder Value Plan (SVP). However, this plan is included in the Remuneration Policy to give the Remuneration Committee flexibility to make an award in the case of a new hire. | Awards do not vest until the third anniversary of the date of grant and may have a deferral element.<br>If employment ceases during the vesting period, awards will by default lapse in full, unless the Remuneration Committee exercises its discretion.<br>The maximum level of award is a 200% base pay multiple, unless the Board determines that exceptional circumstances exist, which justify exceeding this limit, in which case options will not exceed 300% of base pay.<br>The DSOP scheme rules were approved by shareholders in March 2010 as part of the demerger from Carphone Warehouse. |

# Directors' Remuneration Report continued

## Remuneration Policy continued

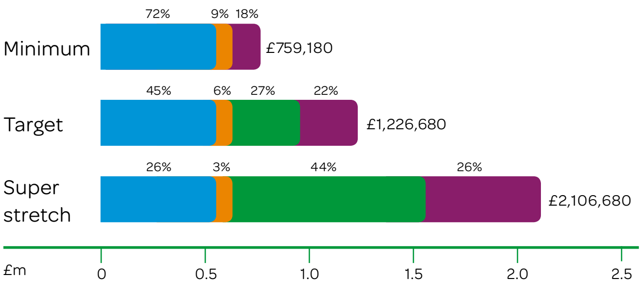
### Summary of remuneration components of Executive Directors continued

| Component | Aim and link to strategy | Description of operation and any performance measures | Further detail on maximum opportunity and framework used to assess performance |
|---|---|---|---|
| **Variable**<br>Share-based incentive plans<br>Shareholder Value Plan (SVP) (award under the VES rules) | Designed to reward and retain Executives over the longer term whilst aligning an individual's interests with those of shareholders and in turn delivering significant shareholder value. | The SVP, awarded under the VES rules, is designed to enable participants to share in the incremental value of the Group in excess of an opening valuation, as determined by the Remuneration Committee and agreed with HMRC. Each award entitles the participant to purchase a fixed number of separate shares ('Participation shares') in the subsidiary company, TalkTalk Group Limited, the holding company for the TalkTalk business.<br>The number of TalkTalk shares issued to each participant is determined by the incremental value pool created above a 7% return to shareholders.<br>In order to avoid the possibility that value is created by a 'rising tide' rather than management performance, the Company's total shareholder return will also be required to outperform the FTSE 250 before any vesting is possible.<br>The vesting of awards will be subject to continued employment and the satisfaction of performance conditions and/or other specified events as determined by the Remuneration Committee.<br>Participation shares that are purchased by participants are acquired at market value and participants are offered a loan from TalkTalk at a commercial rate of interest in order to fund such a purchase.<br>When the awards vest the Participation shares will have a value equal to the corresponding percentage they represent of the incremental value (if any) of the TalkTalk businesses at the time of vesting in excess of the applicable opening valuation and shall then be purchased by the Company for cash and/or by the issue (or transfer) of ordinary shares in the capital of the Company.<br>Any loan made to the participants to acquire Participation shares will be required to be repaid at that time. If the market value of the Participation shares is less than the amount of the outstanding loan (and any accrued interest) then the participant may be required to repay a proportion of the loan, the amount of which the Remuneration Committee may use its discretion to determine.<br>Executive Directors and Executive Committee members will be required to hold 100% of any vested shares for a period of twelve months following vesting. Other participants will be required to hold 50% of vested shares for a twelve month period. Participation shares are generally forfeited to the value of the original loan plus accrued interest in the event that a participant leaves the Company prior to the vesting date. | Awards are discretionary and are made as a 'block award' to last four years rather than an annual award.<br>Each participant is entitled to purchase an agreed number of Participation shares, with no participant being awarded more than 10% of the value of the pool created.<br>60% of the award vests after three years, with the remaining 40% of the award vesting after four years.<br>A cap on the total value of the awards that vest at the end of the four year period applies and total awards will not result in a dilution of the issued share capital of the Company of more than 2.75%.<br>The VES rules were approved by shareholders in March 2010 as part of the demerger from Carphone Warehouse. |

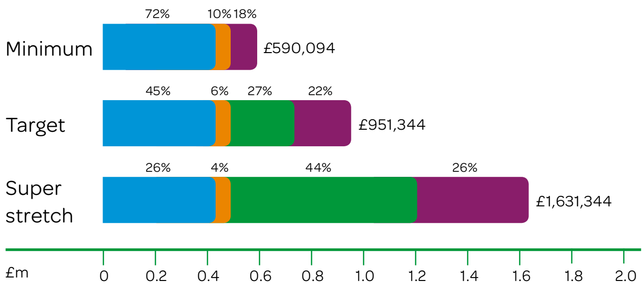
### Remuneration scenarios

The charts below illustrate the level of total remuneration the current Executive Directors could receive under the Remuneration Policy based on four levels of performance to ensure alignment with returns, which are received by our shareholders at: minimum, 'on target', 'stretch' and 'super stretch' levels of performance. The 'on target' level of total remuneration represents performance in line with the Company's expectations and 'super stretch' is considered to be the maximum level of total remuneration in practice, but the cap on the SVP has intentionally been set at a level higher than this.

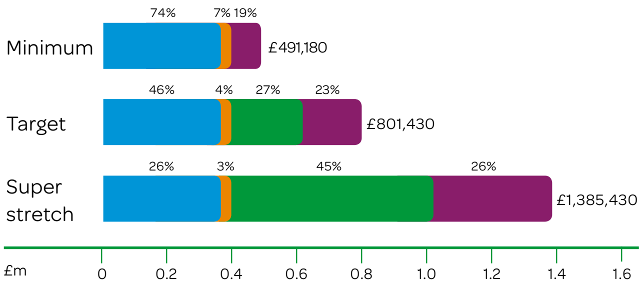
**Chief Executive Officer**
(D Harding)



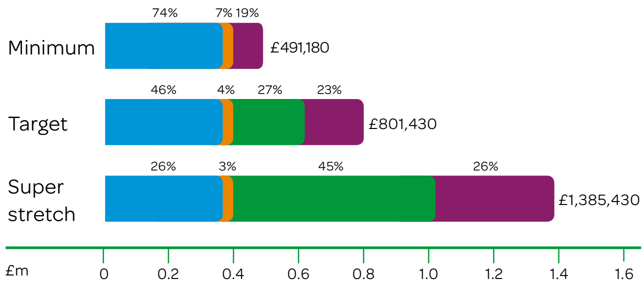

**Chief Financial Officer**
(I Torrens)




**Executive**
(T Harrison)




**Executive**
(C Bligh)




Base pay | Benefits, pension and car allowance | Annual bonus | LTIP

Notes

(1) Base pay is actual base pay in the year ended 31 March 2016.

(2) Taxable benefits are at the level over the year ended 31 March 2016.

(3) Pension is based on a 10% Company contribution/cash in lieu for D Harding, and I Torrens and a 5% Company contribution for T Harrison and C Bligh.

(4) Annual performance bonus is at 60% of base pay for target performance, 110% of base pay for stretch performance and 170% of base pay for super stretch performance.

(5) SVP outcomes include assumed share price increases over the four year performance term.

(6) As SVP is a 'block award' over a four year term rather than an annual award, we have annualised the potential pay-out over a four year period.

# Directors' Remuneration Report continued

## Remuneration Policy continued

### Other share-based remuneration

**TalkTalk Sharesave Scheme (SAYE)**

The Company operates an all-employee, HMRC-approved, Sharesave scheme, which all eligible employees and Executive Directors are able to participate in. All eligible employees are invited to join the scheme on an annual basis, subject to maximum participation levels, currently £500 per month, or in line with HMRC limits if these are increased in the future. Details of current schemes can be found in the Annual Remuneration section of this report.

**TalkTalk Share Match Plan (SIP)**

The Company operates an all-employee, HMRC-approved Share Match Plan. The TTG Share Match Plan enables eligible employees to purchase market priced shares by entering into a partnership share agreement and holding such shares in trust for up to five years. The rules of the Plan allow an employee maximum contribution of £1,800 per annum, or in line with HMRC limits if these are increased. The Remuneration Committee, at its discretion, may award matching and/or free shares to eligible participants. Matching shares may be granted up to a maximum ratio of two matching shares for each partnership share purchased by a participant. Free shares may be awarded up to a maximum value of £3,600 tax free per annum, or in line with HMRC limits if these are increased.

Currently the Company provides one matching share for each partnership share purchased by participating employees or Executive Directors.

### Service contracts and remuneration packages

**Service contracts for Executive Directors**

Under the Executive Directors' service contracts both parties are required to give twelve months' notice of termination of employment. At the Company's discretion they may terminate the contract immediately and not require the Director to work their notice and instead pay twelve months' contractual pay plus benefits. The Executive Directors' service contracts also include a twelve month non-compete period.

These contracts are available for inspection at the Company's registered office.

**Recruitment policy for new hires**

When hiring a new Executive Director, the Remuneration Committee will align the remuneration package with the Remuneration Policy stated above, including the maximum limits for each remuneration component.

The Remuneration Committee will take all relevant factors into consideration when making a remuneration decision on a new Executive hire to ensure that these decisions are being made in the best interests of the Company and its shareholders, including, but not limited to:

- quantum;
- type of remuneration being offered;
- the impact on existing remuneration arrangements for other Directors;
- the remuneration package of any exiting equivalent Director; and
- the remuneration arrangements of the candidate in their previous role.

In hiring a new Executive Director, the Remuneration Committee may also make a 'buy-out' award to an external candidate in compensation for any remuneration arrangements forfeited on leaving a previous employer. In making such an award, the Committee will take into consideration relevant performance conditions, vesting periods and the form in which the award was made. It is usual that any 'buy-out' awards will be made on a comparable basis. In exceptional circumstances, the Remuneration Committee may make an exceptional award under one of the Company's existing long term incentive plans in order to compensate a candidate for any remuneration arrangements forfeited on leaving a previous employer.

The Remuneration Committee would only consider making such awards where the individual has lost an award as a result of joining the Group and awards will be subject to continued employment and performance conditions, as appropriate. Following the appointment of a new Executive Director the shareholders will be informed of the details as soon as practicable.

There may be exceptional and unforeseen circumstances where the Remuneration Committee considers it appropriate to exercise discretion available under Listing Rule 9.4.2-R to grant an award to facilitate the recruitment of an Executive Director. Where a variable or performance related award is made under such circumstances, the Remuneration Committee confirms that the award will be within the limits specified in the Remuneration Policy table.

The Remuneration Committee emphasises that such discretion would only ever be used in genuinely unforeseen and exceptional events where it would be disproportionate to seek shareholder approval at a general meeting. The Remuneration Committee considers that in practice such events would arise highly infrequently, if at all, for the duration of the Remuneration Policy. Where such an event arises, the Remuneration Committee will consult with major shareholders and an explanation on how discretion has been exercised would be provided in the following year's Remuneration Report.

## Service contracts and remuneration packages continued

**Relocation packages**

There may be occasions when hiring a new Executive Director that a relocation package is awarded, where a candidate and/or the candidate's immediate family relocate either on a temporary or permanent basis in order to fulfil their role for the best interests of the Company and its shareholders. In such instances, the Remuneration Committee retains the right to compensate for reasonable and appropriate relocation expenses.

**Expatriate packages**

On appointing a new Executive Director, the Remuneration Committee may offer assistance where a candidate and/or the candidate's immediate family is asked to relocate either on a temporary or permanent basis, from an overseas location to the UK or from the UK to an overseas location. In such instances, the Remuneration Committee retains the right to compensate for reasonable and appropriate relocation expenses.

**Remuneration Policy for internal promotions**

When an existing employee of the Company is promoted internally to the role of Executive Director, the Remuneration Committee will align the remuneration package with the Remuneration Policy stated above, including the factors it takes into account for new hires.

Any remuneration awarded prior to promotion as an Executive Director will be retained and will be subject to the previous payment terms. The shareholders will be informed of any such remuneration in the Directors' Remuneration Report following promotion.

**Exit payments**

The Company operates the following policy in respect of exit payments:

- Executive Directors have a twelve month notice period from the Company and they in turn are asked to give the Company twelve months' notice.
- Exit payments in relation to the service contract are limited to no more than one year's contractual pay plus other benefits, and any contractual notice pay, unless determined otherwise by the Board in exceptional circumstances, or unless otherwise dictated by law.
- The Remuneration Committee may use its discretion to determine appropriate bonus amounts and the vesting of any share-based award, taking into consideration the individual circumstances under which an Executive Director is leaving the Company.

The default position is for annual bonus amounts and the vesting of share-based awards for 'good leavers' to be pro-rated for time served from the start date of the scheme to the individual's exit date and will be subject to the applicable rules of the scheme. The Remuneration Committee will have sole discretion to determine the 'good leaver' status of an Executive Director. The Committee will determine on a case by case basis whether any vesting of a share-based award is appropriate.

**Fees for Non-Executive Directors**

The Non-Executive Directors do not take part in discussions on their remuneration. Each of the Non-Executive Directors has a letter of appointment substantially in the form suggested by the Code, and each has a three month notice period with no compensation for loss of office. The Company has no age limit for Directors. The dates of each contract are set out on page 53.

The fees for Non-Executive Directors are set out on page 52 of this report. These fees are reviewed (but not necessarily increased) on an annual basis, taking into account the responsibilities of the role and their participation in the various governance committees of the Company.

Non-Executive Directors are not entitled to participate in any annual or long term incentive plans, or any pension arrangements.

**External appointments**

The Board supports Executive Directors holding Non-Executive Directorships of other companies and believes that any such appointments are part of the continuing development of the Executive Directors from which the Company will ultimately benefit. The Board has reviewed all such appointments and those appointments that the Board believes require disclosure pursuant to the Code are set out on page 53. The Board has also agreed that the Directors may retain their fees from such appointments.

# Directors' Remuneration Report continued

## Annual Report on Remuneration

**The following sections set out how the Company's Remuneration Policy was implemented in the year ended 31 March 2016 and how it will be implemented for the year ending 31 March 2017.**

### Single figure of remuneration*

To assist shareholders' understanding and in line with the Regulations, the table below provides a single figure of remuneration for each Executive Director. The information for Non-Executive Directors is included in the table on page 52.

**Year ended 31 March 2016**

| Executive Director | Base pay(1) £000 | Taxable benefits(2) £000 | Pension(3) £000 | Bonuses(4,5) £000 | LTIP(6,7) £000 | SAYE gain(8) £000 | 2016 total £000 |
|---|---|---|---|---|---|---|---|
| D Harding | 550 | 17 | 55 | 220 | 1,968 | – | 2,810 |
| I Torrens | 425 | 16 | 42 | 170 | – | 6 | 659 |
| C Bligh(9) | 365 | 17 | 18 | 146 | 1,023 | – | 1,569 |
| T Harrison(9) | 365 | 17 | 18 | 146 | 945 | – | 1,491 |
| Aggregate emoluments | 1,705 | 67 | 133 | 682 | 3,936 | 6 | 6,529 |

(1) Value of base pay received in the year.

(2) Value of benefits received by the Director in the year.
The components of taxable benefits are as follows:
- car allowance – cash amount received in the year; and
- private medical insurance – cost to the Company in the year for the Executive Director and their family.

(3) Value of pension contribution or cash in lieu made by the Company in the year.

(4) Value of annual bonus payable in respect of the year and based on performance for the financial year.

(5) D Harding has decided to donate her bonus to charitable causes.

(6) Value of LTIP vesting in the year. This relates to the DSOP 2012, 50% of which vested in May 2015, after the TSR performance condition was determined to have exceeded its Super Stretch level. The remaining 50% of the award relating to EPS, immediately lapsed on 14 May 2015. The share price on the date of vesting was £3.841.

(7) Original DSOP 2012 award was made as a multiple of base pay. At the time of the award, C Bligh's base pay was £325,000 and T Harrison's base pay was £300,000.

(8) Under the 2015 SAYE I Torrens was granted 5,863 options on 12 June 2015 at an option price of £3.07.

(9) C Bligh and T Harrison's base pay was increased from £335,000 to £375,000 effective 1 July 2015 as disclosed in last year's report.

**Year ended 31 March 2015**

| Executive Director | Base pay(1) £000 | Taxable benefits(2) £000 | Pension(3) £000 | Bonuses(4) £000 | LTIP £000 | SAYE gain(5) £000 | 2015 total £000 |
|---|---|---|---|---|---|---|---|
| D Harding | 538 | 16 | 58 | 432 | – | 3 | 1,047 |
| S Makin(6) | 248 | 9 | 25 | 241 | – | – | 523 |
| I Torrens(7) | 106 | 4 | 11 | 85 | – | – | 206 |
| C Bligh(8) | 278 | 14 | 14 | 224 | – | – | 530 |
| T Harrison(8) | 278 | 14 | 14 | 224 | – | – | 530 |
| Aggregate emoluments | 1,448 | 57 | 122 | 1,206 | – | 3 | 2,836 |

(1) Value of base pay received in the year.

(2) Value of benefits received by the Director in the year.
The components of taxable benefits are as follows:
- car allowance – cash amount received in the year; and
- private medical insurance – cost to the Company in the year for the Executive Director and their family.

(3) Value of pension contribution or cash in lieu made by the Company in the year.

(4) Value of annual bonus payable in respect of the year and based on performance for the financial year.

(5) Under the 2014 SAYE D Harding was granted 3,750 options on 13 June 2014 at an option price of £2.40.

(6) The figures in this table are for the period S Makin was a Director to 13 November 2014. The base pay, taxable benefits and pension received for his employment not as a Director up to 31 December 2014 amounted to £68,348, which included £9,576 in lieu of accrued annual holiday, not taken by his exit date on 31 December 2014. The Bonus figure for S Makin includes the period from 14 November 2014 to 31 December 2014, when he was not a Director.

(7) The figures in this table are for the period I Torrens was a Director from 5 January 2015.

(8) The figures in this table are for the period C Bligh and T Harrison were Directors from 3 June 2014. C Bligh and T Harrison's base pay was set at £335,000 on their appointment to the Board, effective from 1 July 2014.

## Appointments in the year ended 31 March 2016

Roger Taylor was appointed as a Non-Executive Director on 11 November 2015 and his fee was set in line with the Remuneration Policy at £45,000. On 11 January 2016, Roger Taylor was appointed to the Remuneration Committee and his fee was adjusted accordingly, increasing to £50,000.

In line with the Remuneration Policy, the Committee considered both internal and external factors when setting the remuneration package for the newly appointed Non-Executive Director, in order to ensure that the decisions taken were made in the best interests of the Company and its shareholders.

## Leavers in the year ended 31 March 2016

There were no leavers in respect of Executive Directors or Non-Executive Directors in the year ending 31 March 2016.

## Base pay

### Year ended 31 March 2016

As previously disclosed in last year's report, following the Committee's review of Executive remuneration in the year ended 31 March 2015, it was agreed that the base pay of both Tristia Harrison and Charles Bligh would be increased to £375,000, which was a 12% uplift and was effective from 1 July 2015. As previously disclosed, in line with the Remuneration Policy, under normal circumstances no Executive Director will receive an increase in excess of 10% of their base pay in any given financial year, however, the Committee took into consideration the contribution the Managing Director of Consumer and the Managing Director of TalkTalk Business, Technology and Security had made since their appointment to the Board and the increased responsibilities that these positions carry, as well as the ongoing contribution that they will continue to make to the business.

As previously disclosed, remuneration increases for Executive Directors were reviewed in line with market trends, peer group benchmarking and current internal practices. Peer group analysis was conducted by Willis Towers Watson, comparing against FTSE-listed companies with comparable revenue and market capitalisation.

For the year ended 31 March 2016 average base pay increases for all other employees was 2%.

### Year ending 31 March 2017

There are no proposed increases to base pay for Executive Directors in the year ending 31 March 2017.

For the year ending 31 March 2017, average base pay increases for all other employees will be 2%. This year, not all employee increased will be applied and business units have had complete discretion to apply their pay budget. Within the 2% pay budget, adjustments were made in order to ensure that no employee of the Company is in receipt of base pay lower than the Living Wage, in line with the commitment made in April 2015.

## Pension contributions*

### Year ended 31 March 2016

During the course of the year, Executive Directors received Company pension contributions in line with the Remuneration Policy. There were no Directors who were members of a defined benefit pension scheme during the year.

Dido Harding had previously left the pension scheme at the end of February 2014 and therefore a cash payment in lieu of pension, equivalent to 10% of base pay, was made for the year ending 31 March 2016.

Iain Torrens chose not to join the Company pension scheme on his appointment and therefore a cash payment in lieu of pension, equivalent to 10% of base pay, was made for the year ended 31 March 2016.

Pension contributions for Tristia Harrison and Charles Bligh were made by the Company of 5% of their base pay for the year ended 31 March 2016.

The pension schemes provided for other employees of the Group are included in note 4 to the consolidated financial statements.

### Year ending 31 March 2017

In the year ending 31 March 2017, pension contributions from the Company for Dido Harding and Iain Torrens will continue to be capped at 10% of base pay, in line with the Remuneration Policy, and will be paid as a cash payment in lieu. Pension payments for Charles Bligh and Tristia Harrison will be capped at 5% of base pay, in line with the Remuneration Policy.

## Annual performance bonus

### Year ended 31 March 2016

For the year ended 31 March 2016, the annual performance bonus was based on a 'balanced scorecard' blend of financial and non-financial measures as set out in the table below and in line with the approved Remuneration Policy, Executives had an incentive opportunity in the range of 0% to 170% of base pay.

Performance against the Annual Bonus scheme targets would have resulted in a scheme pay-out of 62.4% of base pay for the Executive Directors. Whilst this would have been significantly lower than the previous years' pay-out of 80.5%, in the context of the cyber attack on TalkTalk and after careful consideration, the Remuneration Committee has exercised discretion and determined that the annual bonus should be at a reduced level of 40% of base pay to reflect those events.

Achievement against the measures can be seen in the table below:

| Measure | Weighting | Achievement |
|---|---|---|
| Headline Group EBITDA | 25% | Between Minimum and Target |
| Group Revenue | 20% | Minimum |
| On-net churn | 25% | Between Target and Stretch |
| Transformation | 20% | Between Target and Stretch |
| Innovation | 10% | Super stretch |

# Directors’ Remuneration Report continued

## Annual Report on Remuneration continued

### Annual performance bonus continued

**Year ended 31 March 2016** continued

When determining bonus payments, and the resulting adjustment down this year, the Remuneration Committee takes into account performance against the measures above, overall business performance and the individual performance of the Executive Directors.

Significant investment in the year in our fibre and mobile propositions, coupled with investment in security following October’s cyber attack has resulted in the majority of financial measures being confirmed at between minimum and target. Considered focus for the year on customer churn, accelerated growth within TalkTalk Business and a strong pipeline for innovation has delivered stronger performance against the remainder of the scorecard, which has resulted in a bonus being paid out to Executive Directors at just below target levels.

The Remuneration Committee has carefully considered the strong business recovery which the Company has demonstrated in the wake of recent events and is satisfied that this bonus has provided a significant link between reward and operating performance and the creation of further shareholder value.

The Remuneration Committee has judged that the targets are commercially sensitive as they could give competitors insight into TalkTalk’s business planning process, but having discussed the matter at length, has determined that performance against targets should be reported retrospectively, two years in arrears, as the Committee feels that sufficient time has passed from the setting of targets and reporting of achievement against them. Targets and performance against them have therefore been disclosed for the Annual Performance Bonus for the year ending 31 March 2014 in the table below:

| Measure | Weighting | Actual performance vs target | Achievement |
|---|---|---|---|
| Headline Group EBITDA (£m) | 20% | 87% | Missed |
| Group operating free cash flow (£m) | 10% | 69% | Missed |
| On-net churn (%) | 20% | 84% | Missed |
| TV numbers and customer experience (‘000s) | 10% | 108% | Super stretch |
| On-net ARPU (£) | 10% | 107% | Super stretch |
| TTB Revenue (£m) | 10% | 102% | Stretch |
| NPS | 10% | 95% | Minimum |
| Innovation | 5% | See note 1 | Super stretch |
| Employee Engagement | 5% | See note 2 | Stretch |

(1) Innovation performance measured as – Making TalkTalk Simpler plan in place, Mobile Strategy defined and TalkTalk Business new product development pipeline in place – all delivered at super stretch level; Group innovation Pipeline in place – delivered at Stretch Employee Engagement performance measured as – improve perceptions of career development, address barriers to collaboration and cross- departmental working – all delivered at Stretch level; shift employee perceptions of how we treat our customers – delivered at super stretch level.

(2) Employee Engagement performance measured as – improve perceptions of career development, address barriers to collaboration and cross- departmental working – all delivered at Stretch level; shift employee perceptions of how we treat our customers – delivered at super stretch level.

**Year ending 31 March 2017**

A review of the annual bonus scheme was conducted in the year ending 31 March 2016 to ensure that the performance measures in the balanced scorecard continue to be aligned to Company strategy. The performance measures and their weightings for the year ending 31 March 2017 are set out below:

| Performance measure | Weighting |
|---|---|
| Headline Group EBITDA | 25% |
| Group Revenue | 20% |
| Customer (including network performance) | 30% |
| Innovation | 10% |
| Transformation | 15% |

The Board has determined that the disclosure of performance targets continues to be commercially sensitive and they are therefore not disclosed in this report. These targets are determined within the context of a longer term business plan and the disclosure of these targets could give information to TalkTalk’s competitors to the detriment of business performance.

The Committee will disclose performance against all these measures in next year’s Directors’ Remuneration Report.

There is no change to the annual bonus policy for Executive Directors which is set out in the Remuneration Policy table, with the exception of new performance measures and weightings shown above.

## Share-based incentive plans*

**Year ended 31 March 2016**

The single figure of remuneration includes amounts for the value of options to acquire ordinary shares in the Company granted to or held by the Directors. Details of the options for the Directors who served during the year are as follows:

### The TalkTalk Group Shareholder Value Plan (SVP) (awarded under the Value Enhancement Scheme (VES) rules)

No awards were made under the SVP in the year ending 31 March 2016.

Participation shares were acquired in 2014 and loans granted by the Company. Interest is accrued on the loan on an annual basis. A subsequent loan is provided to participants on an annual basis, until the scheme vests, at which point the loans plus accrued interest are repaid. Loans were outstanding to the following Executives in the year ended 31 March 2016:

| Director | 2016 % share of pool | 2016 Number of Participation shares purchased | 2016 Outstanding loan and Interest |
|---|---|---|---|
| D Harding | 10 | 2,000,000 | 325 |
| I Torrens[1] | 5 | 1,000,000 | 191 |
| T Harrison | 5 | 1,000,000 | 163 |
| C Bligh | 5 | 1,000,000 | 163 |
| | 25 | 5,000,000 | 842 |

(1) Award to I Torrens made on 2 February 2015, resulting in a higher cost per Participation Share than original participants.

The remaining percentage of allocated shares in the SVP pool is held by other senior management of the Group.

Interest on outstanding loans was charged at 3.00% during the year.

There were no awards made under the SVP to Executive Directors, there was no clawback and no Non-Executive Directors participated in this scheme during the year ended 31 March 2016.

### TalkTalk Discretionary Shares

The TalkTalk Discretionary Share Option Plan (DSOP) is designed to provide a long term incentive plan for certain employees of the TalkTalk Group. It is the intention of the Committee that, generally in any one year, participants may only receive an award under one such scheme.

### Scheme interests awarded in the year

There were no awards granted under the DSOP during the year to Executive Directors and no Non-Executive Directors participated in this scheme.

### Scheme interests vesting in the year

During the course of the year ending 31 March 2016, having reviewed the relevant performance conditions and having determined that the minimum 5% Total Shareholder Return (TSR) CAGR hurdle had been met, the Committee determined that the DSOP award made in 2012 should partially vest on 14 May 2015. Half of the award, which was subject to a TSR performance condition was determined to have exceeded its super stretch level, with performance achieving 32.7% CAGR against a super stretch target of 17%. The remaining 50% of the award, which was measured against an earnings per share (EPS) performance condition was missed, with performance significantly below the minimum target of 19%. As a result, the entire award related to the EPS measure therefore lapsed on 14 May 2015. 60% of the vested award was immediately available to exercise and the remaining 40% of the vested award will be available to exercise from 12 May 2016.

The partial vesting of the DSOP 2012 resulted in 512,295 nil-priced options vesting in respect of D Harding, and 266,393 and 245,901 nil-priced options vesting in respect of C Bligh and T Harrison respectively. D Harding exercised nil-priced options over 307,377 ordinary shares of £0.01 each and sold all of the shares for £3.7935 each on 14 May 2015.

The Remuneration Committee undertook a prudent review of the scheme vesting following October's cyber attack, to determine whether any adjustment was appropriate in relation to the level of the award which vested in May 2015. The Committee felt that the significant outperformance against the TSR measure was an accurate reflection of performance over the period of the DSOP 2012. It was therefore determined that this coupled with the strong business recovery since October, should result in no adjustment being made to the award which had previously vested. As a result of this decision, there was no clawback in respect of this scheme during the year ended 31 March 2016.

In line with the Remuneration Policy, the Committee, at its sole discretion, may, in hiring a new Executive Director, make a 'buy-out' award to an external candidate in compensation for any remuneration arrangements forfeited on leaving a previous employer. There have been no buy-outs in relation to Executive Directors in the year ending 31 March 2016.

All awards currently held by Executive Directors are detailed in the following table.

# Directors' Remuneration Report continued

## Annual Report on Remuneration continued

**Share-based incentive plans*** continued

**Year ended 31 March 2016** continued

### Total DSOP & CSOP under option at year ended 31 March 2016

| Director | Scheme type | Type of award | Performance conditions apply(4) | Average share price used for grant | Face value of award(1) | Minimum level of award | Vesting date |
|---|---|---|---|---|---|---|---|
| D Harding(5) | DSOP 2012 | Nil priced unapproved | Yes | £1.22 | £250,000 | 25% | May 2015(2) |
| | DSOP 2013 | Nil priced unapproved | Yes | £2.21 | £1,000,000 | 25% | June 2016(3) |
| I Torrens(6) | DSOP 2014 | Nil priced unapproved | No | £3.19 | £376,116 | 100% | February 2018 |
| T Harrison | DSOP 2012 | Nil priced unapproved | Yes | £1.22 | £300,000 | 25% | May 2015(2) |
| | DSOP 2013 | Nil priced unapproved | Yes | £2.21 | £600,000 | 25% | June 2016(3) |
| | CSOP 2008(7,8,9) | Priced unapproved | Yes | £0.51 | £63,750 | 25% | June 2010 |
| C Bligh | DSOP 2012 | Nil priced unapproved | Yes | £1.22 | £325,000 | 25% | May 2015(2) |
| | DSOP 2013 | Nil priced unapproved | Yes | £2.21 | £650,000 | 25% | June 2016(3) |
| | | | | | £3,564,866 | | |

(1) Face value is calculated as the number of remaining options awarded multiplied by the average share price over the five day period prior to grant.

(2) 50% of the award vested and 50% of the award was lapsed in May 2015 due to the EPS measure being missed and the TSR measure exceeding the super stretch Level. 60% of the award was exercisable in May 2015 with the remaining 40% being exercisable from May 2016.

(3) 60% exercisable from June 2016 and remaining 40% exercisable twelve months thereafter.

(4) Performance conditions are set out in the Annual Report 2015.

(5) D Harding exercised and immediately sold 307,377 shares from the DSOP 12 award which vested in May 2015, on 11 November 2015 for £3.7935 per share.

(6) 100% exercisable from February 2018.

(7) Face value is calculated as the number of remaining options awarded multiplied by the option price.

(8) 50% of the award vested in June 2010 and 50% and 50% of the award vested in March 2011.

(9) This award was made prior to the demerger from Carphone Warehouse in 2010 and was omitted from last year's report.

**Year ending 31 March 2017**

### The TalkTalk Group Shareholder Value Plan (SVP)

Following careful consideration of and in line with our approved Remuneration Policy, the Company proposes to make further awards under the Shareholder Value Plan (SVP) which operates under the rules of the Value Enhancement Scheme (VES) approved by shareholders in January 2010, to the four Executive Directors and a small number of our senior leadership team.

The Company strongly believes that it is important to continue to attract, incentivise and motivate senior employees in this manner and, taking into account Company performance in the previous financial year, it recognises that it is essential to continue to align the interests of the Company, shareholders and key senior employees. The Company wants to ensure that it retains the highest quality of talent with the requisite skills and to ensure that it motivates these individuals to achieve outstanding levels of performance.

As set out in our approved Remuneration Policy, the Company believes that due to the evolving and dynamic nature of the Company and its growth aspirations, the SVP is the most appropriate vehicle to realign the interests of senior leaders to those of our shareholders. The Company is confident that the proposed award will incentivise the team to create significant value for shareholders, for the next phase of development of the business over the coming three to four years. In line with previous awards, performance conditions will apply such that there first needs to be at least a 7% compound annual increase in the Company's market capitalisation. Additionally, in order to avoid the possibility that value is created by a "rising tide" rather than management performance, the Company's total shareholder return will also be required to outperform the FTSE 250 over the respective performance periods before any vesting is possible. These conditions are also in line with our Policy and are the same conditions as apply to the 2014 awards.

In making its proposal, the Remuneration Committee has carefully considered the fact that, whilst in line with our Policy, a new award will be made earlier than had originally been anticipated. The Committee believes, however, that this is the most appropriate way in which to align the interests of all parties following recent events and will further aid the strong business recovery that has recently been demonstrated and as highlighted in our Preliminary results for FY16. Participants who were granted awards under the SVP in 2014 will also participate in the proposed new awards. With this in mind, the Committee has determined that no participant should benefit from both sets of award and therefore any participant gain realised from the 2014 award would first be deducted from any participant gain realised from the 2016 award.

In accordance with our approved Policy the level of award granted to each individual, will be determined by the Remuneration Committee and each award will recognise the individual's performance, including exceptional performance, but no individual participant shall be awarded more than 10% of the total SVP pool value. In addition, a cap on the total

**Share-based incentive plans*** continued

**Year ending 31 March 2017** continued

The TalkTalk Group Shareholder Value Plan (SVP) continued

value of the aggregated awards that vest at the end of the four year period shall apply equal to 2.75% of the Company's market capitalisation at the time. This is in line with our Policy. All of the above percentages and caps will be further aggregated across both the 2014 and 2016 awards at the end of the four year vesting period for the new awards to further ensure there is no double benefit as stated above.

Each participant will be entitled to purchase at market value an agreed number of participation shares as stated below. Subject to the performance conditions being achieved each time, 60% of the award will vest after three years, with the remaining 40% of the award vesting after four years.

Participants will be offered loans (on full commercial terms) in order to purchase shares in our operating subsidiary company, TalkTalk Group Limited ("SVP Shares"). On vesting, these shares will be acquired by the Company in return for the issue of ordinary shares in the Company to participants or alternatively they may be purchased for cash. Based on the performance conditions, for any payment to be made to participants, the total value created by the Company would be equivalent to a share price increase in the region of at least 30% over the period.

If this stretching performance threshold is not achieved, no payment will be due. However, participants will still be required to settle the loans which have been made to them and if the value of the SVP Shares is less than the value of the loans, the Remuneration Committee has the discretion to require participants to pay 20% of this deficit. The Committee believes that this part of the awards will provide a strong further alignment between participants and shareholders.

TalkTalk Discretionary Shares

The Remuneration Committee intends to make an award in 2016 under the DSOP rules approved by shareholders in 2010 to members of the senior management group, who will not participate in the proposed SVP award detailed above.

The exercise of any options awarded under this scheme will be dependent on continued employment and the achievement of performance conditions, set out below:

- The value delivered to shareholders of the Company should outperform the growth of the Retail Prices Index ("RPI"); and
- TalkTalk Group's shareholder return should outperform that of the FTSE 250.

Awards under this scheme will vest in 2019 with 60% of the vested award being exercisable in 2019 and the remaining 40% being exercisable in 2020.

**All-Employee Share Plans***

**TalkTalk Sharesave Scheme (SAYE)**

The TalkTalk Sharesave Scheme is a Save-As-You-Earn (SAYE) share option scheme and is approved by HMRC. The SAYE Scheme is administrated by a duly authorised committee of the Board. All UK Executive Directors and employees of TalkTalk and participating companies within the Group are eligible to participate in the Sharesave Scheme as long as they have been employed for a qualifying period. To participate in the Scheme an eligible employee must enter into a Sharesave contract and agree to make monthly contributions between £5 and £500 for a specified period of three or five years.

Options granted to acquire TalkTalk Shares under the Scheme have an option price determined by the TalkTalk Board, which will be not less than the higher of 80% of the middle market quotation price or their nominal value.

Iain Torrens was awarded 5,863 share options under the 2015 scheme at an option price of £3.07, which has been reflected in the single figure table detailed above.

No Non-Executive Directors participated in this scheme.

Further details of the features and operations of the Sharesave Scheme can be found in note 5 to the consolidated financial statements.

**All-employee Share Match Plan (SIP)**

In June 2014, the Company introduced an all-employee, HMRC-approved Share Incentive Plan or SIP, Share Match Plan, which had been approved by the Remuneration Committee during the previous financial year. This enables eligible employees to purchase market priced shares by entering into a partnership share agreement and holding such shares in trust for up to a five year period. Approval for the TTG Share Match Plan was granted by shareholders at the AGM on 24 July 2013.

Both Dido Harding and Iain Torrens have received the following shares in respect of the Share Match Plan during the period ended 31 March 2016:

| | Partnership shares purchased | Matching shares allocated | Total number of shares held in plan |
|---|---|---|---|
| D Harding[(1)] | 644 | 644 | 1,288 |
| I Torrens[(1)] | 661 | 660 | 1,321 |

(1) These awards have been included in the shareholding numbers reflected in the table outlined on page 52.

# Directors' Remuneration Report continued

## Annual Report on Remuneration continued

### Additional information

**Shareholding requirements**

Executive Directors are required to build and retain a minimum shareholding in the Company, equivalent to 200% of base pay. Current shareholdings are set out below for Executive Directors:

| Director | Holding Requirement as a % of base pay | Actual holding | Requirement satisfied | Actual share ownership as a % of base pay(1) |
|---|---|---|---|---|
| D Harding | 200% | 4,296,438 | Yes | 1,867% |
| I Torrens | 200% | 1,411 | No(2) | 1% |
| C Bligh | 200% | 617,987 | Yes | 394% |
| T Harrison | 200% | 1,282,934 | Yes | 818% |

(1) Share price on 31 March 2016 used for calculation.
(2) I Torrens joined in 2015 and has the opportunity to build up his shareholding over a number of years in line with the approved Remuneration Policy.

Whilst there are no shareholding requirements for Non-Executive Directors, this is encouraged within the Company.

| | Ordinary shares of 0.1p | | |
|---|---|---|---|
| Director | **31 March 2016** | 31 March 2015 | Date of contract |
| C Dunstone | **294,059,396** | 294,059,396 | 20 January 2010 |
| J Gildersleeve | **246,000** | 246,000 | 20 January 2010 |
| I West | **346,023** | 346,023 | 8 February 2011 |
| J Allwood | **10,000** | 10,000 | 20 January 2010 |
| B Hoberman | **12,882** | 12,882 | 20 January 2010 |
| H Stringer | **10,000** | 10,000 | 26 July 2012 |
| J Powell | **1,000** | 1,000 | 26 July 2012 |
| R Taylor(1) | **3,153,792** | – | 11 November 2015 |

(1) Appointed to the Board on 11 November 2015.

**Fees for Non-Executive Directors**

Remuneration for Non-Executive Directors is set by the Board, taking account of the commitments and responsibilities of the role and their participation in the various governance committees of the Company.

The fees for Non-Executive Directors and their appointment dates are set out in the tables below. Non-Executive Directors are not eligible to participate in annual bonus, LTIP and pension arrangements.

| Non-Executive Director | **Fees £000** | **Taxable benefits £000** | **2016 total £000** | Fees £000 | Taxable benefits £000 | 2015 total £000 |
|---|---|---|---|---|---|---|
| C Dunstone | **360** | **1** | **361** | 360 | 1 | 361 |
| J Gildersleeve | **80** | **–** | **80** | 80 | – | 80 |
| I West | **80** | **–** | **80** | 80 | – | 80 |
| J Allwood | **65** | **–** | **65** | 65 | – | 65 |
| B Hoberman | **50** | **–** | **50** | 50 | – | 50 |
| H Stringer | **50** | **–** | **50** | 50 | – | 50 |
| J Powell | **50** | **–** | **50** | 50 | – | 50 |
| R Taylor(1,2) | **17** | **1** | **18** | 15 | – | 15 |
| Aggregate emoluments | **752** | **2** | **754** | 750 | 1 | 751 |

(1) Appointed to the Board on 11 November 2015.
(2) Appointed to the Remuneration Committee on 11 January 2016. Fee adjusted to £50,000 per annum from this date.

There were no changes to fee levels for Non-Executive Directors in the year and no increases are proposed in the year ending 31 March 2017, except where there are changes in the membership of the various committees of the Board.

## Additional information continued

### Payments to past Directors

In the year ended 31 March 2016, there were no payments made to past Directors not disclosed elsewhere in the report.

### Payments for loss of office

In the year ended 31 March 2016, there were no payments made to Executive Directors, past or present, in compensation for loss of office.

### Non-Executive Directors' letters of appointment

The Committees that Non-Executive Directors serve on and dates of appointment are set out below:

| Non-Executive Director | Committee membership | Date first appointed to the Board | Effective date of current letter of appointment |
|---|---|---|---|
| C Dunstone | – | 20 January 2010 | 16 January 2013 |
| J Gildersleeve | Remuneration, Nomination | 20 January 2010 | 16 January 2013 |
| J Allwood | Audit, Nomination | 20 January 2010 | 20 January 2013 |
| B Hoberman | Remuneration | 20 January 2010 | 20 January 2013 |
| I West | Audit, Nomination, Remuneration | 8 February 2011 | 16 May 2013 |
| H Stringer | Nomination | 26 July 2012 | 26 July 2012 |
| J Powell | Audit | 26 July 2012 | 26 July 2012 |
| R Taylor | Remuneration | 11 November 2015 | 11 November 2015 |

### Fees for external appointments

| Director | Organisation | 2016 £000 |
|---|---|---|
| D Harding | Bank of England | 17 |

Charles Dunstone is also Chairman of Dixons Carphone Group PLC, which the Company believes is a significant other commitment for him.

### Advice and services provided to the Remuneration Committee

Except when matters concerning their own positions are being considered, the Chief Executive Officer and the Group Human Resources Director are normally invited to attend the meetings of the Remuneration Committee. The Committee may discuss any matter affecting the Chairman without the Chairman being present.

Over the course of the year ended 31 March 2016, the Remuneration Committee was advised on matters relating to Executive remuneration by Willis Towers Watson. The Remuneration Committee deems the advisers to be independent from the Company and the advice it received during the year to be appropriate and objective.

Willis Towers Watson is a signatory to the Remuneration Consultants' Group Code of Conduct in relation to executive remuneration consulting in the UK.

The fees paid for services are set out below:

| Company | Nature of service | 2016 £000 |
|---|---|---|
| Willis Towers Watson[1] | Remuneration benchmarking and long term incentive design | 35 |

(1) Towers Watson merged with Willis Group in January 2016 to form Willis Towers Watson.

### Relative importance of spend on pay

The difference in actual expenditure between FY15 and FY16 on remuneration for all employees in comparison to distributions to shareholders by way of dividends is set out in the graphs below:

**Dividend paid (£m)** +£19m


**Total employee pay (£m)** +£17m

# Directors' Remuneration Report continued

## Annual Report on Remuneration continued

### Additional information continued

**Comparing pay to performance**

The following tables and chart show a comparison of total pay for the CEO since the listing of the Company on 29 March 2010, with the remuneration of all other employees and with TSR.

| | Single figure of remuneration(1) | Bonus as a % of maximum available | Shares vesting as a % of maximum(2) |
|---|---|---|---|
| **2011** £000(3) | 920 | 19.9% | – |
| **2012** £000(3,4) | 967 | 40.0% | – |
| **2013** £000 | 5,617 | 39.2% | 100% |
| **2014** £000 | 6,842 | 37.6% | – |
| **2015** £000 | 1,047 | 47.3% | – |
| **2016** £000 | **2,810** | **23.5%** | **50%** |

(1) The increase in the single figure number in 2013 represents the vesting of the first LTIP award since the listing of the Company.

(2) It is not possible to show this value for the VES which vested in 2012 and 2013 as does not have a maximum % of shares. However, for information the 2010 DSOP award vested at 100% of the maximum in 2012.

(3) Maximum bonus for Executive Directors was 200% base pay for the years ended 31 March 2011 and 2012.

(4) Only the 50% relating to TSR measures of the DSOP 2012 vested in May 2015.

The table below shows the percentage change in remuneration between 2015 and 2016 for the CEO and all other employees of the Group.

| | Base pay % change | Taxable benefits % change | Annual bonus % change |
|---|---|---|---|
| CEO (1,2) | 2% | 6% | -49.13% |
| Employees | 2% | 0% | 52% |

(1) D Harding received a Base Pay increase to £550,000 in July 2014, which was previously disclosed in last year's report.

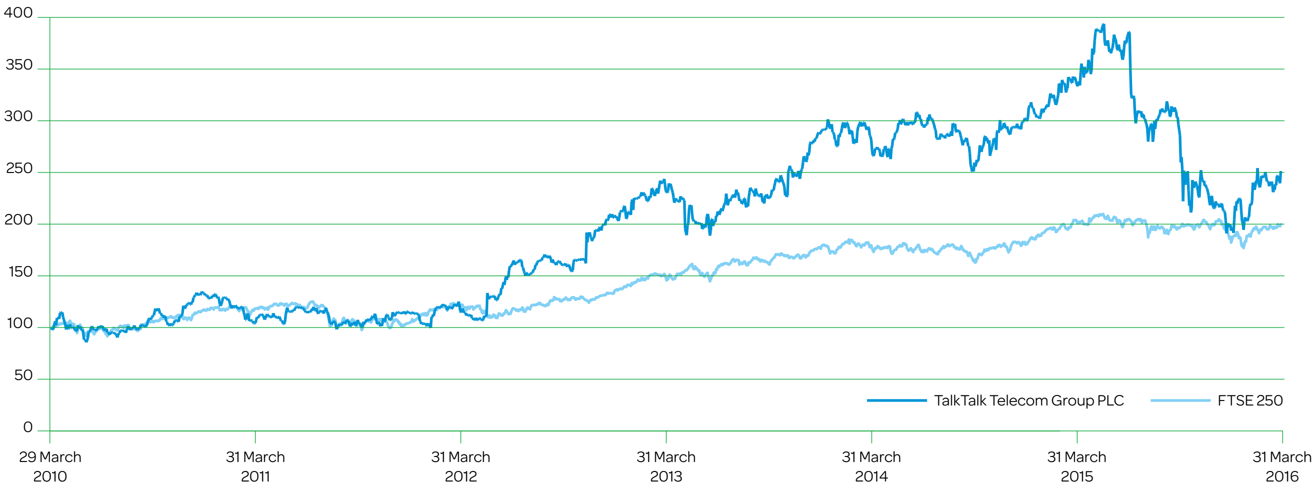
(2) Increase in taxable benefits is due to an increase in the annual premium of the Private Medical Insurance in the year ending 31 March 2016.

**Additional information** continued

**TSR performance graph**

The graph below shows the Group's performance compared to the TSR performance of the FTSE 250 from the date of the Group's listing on 29 March 2010.

The FTSE 250 was selected as it is a broad market index of which the Group is a member.




This Remuneration Report has been prepared in accordance with the Large and Medium-sized Companies and Group (Accounts and Reports) (Amendment) Regulations 2013 ('Regulations') issued under the Companies Act, the UK Corporate Governance Code, The GC 100 and Investor Group Directors' Remuneration Reporting Guidance and the Executive Remuneration Principles published by the Association of British Insurers in November 2013. The constitution and operation of the Remuneration Committee are in compliance with the Code.

In framing its Remuneration Policy the Committee has given full consideration to the matters set out in Schedule A of the Code and the Regulations. As required by the Regulations, resolutions to approve the Remuneration Policy section and the overall Directors' Remuneration Report will be proposed at the 2016 AGM. Voting regarding the 2015 Directors' Remuneration Report was as follows:

| | Votes for | Votes against | Votes withheld | Total votes |
|---|---|---|---|---|
| **Remuneration Report** | 681,304,215 | 30,874,418 | 22,514,479 | 734,693,112 |
| | 92.73% | 4.20% | 3.07% | |

**John Gildersleeve**

**Remuneration Committee Chairman**

12 May 2016

# Other statutory information

### Reporting requirements

The Group is required to produce a Strategic Report complying with the requirements of Section 414A of the Companies Act 2006 ('the Act'). The Group has complied with this requirement and incorporates a detailed review of the Group's activities, business performance and developments during the year and an indication of likely future developments on pages 4 to 26.

The corporate governance statement, as required by Rule 7.2.1 of the Financial Conduct Authority (FCA) Disclosure and Transparency Rules, is set out on pages 30 to 33 of the Corporate governance report and forms part of the Directors' Report.

For the purposes of DTR 4.1.5R(2) and DTR 4.1.8R the Directors' Report is the management report.

### Suppliers' payment policy

It is the Company's policy to develop and maintain key commercial relationships with its suppliers, one aspect of which is payment timing, to obtain mutually agreed payment terms. The Company has commercially agreed longer credit terms with one of its larger corporate suppliers. Excluding this supplier, the underlying average credit period taken on trade payables was 40 days (2015: 33 days). Including this supplier, the average credit period taken was 56 days (2015: 43 days). The Company is compliant with the Department for Business, Innovation and Skills' Prompt Payment Code and is currently in the process of completing an application to be a formal signatory.

### Contracts with controlling shareholders

Sir Charles Dunstone is a controlling shareholder within the definition set out in the Listing Rules. In compliance with Listing Rule 9.2.2AR(1), the Company has entered into a written and legally binding agreement with Sir Charles under which he has agreed to comply with the independence provisions set out in Listing Rule 6.1.4DR by giving the following undertakings to the Company: that any transactions and arrangements with him (or his associates) will be conducted at arm's length and on normal commercial terms, and that neither himself (nor his associates) will take any action that would have the effect of preventing the Company from complying with the Listing Rules or propose the proposal of a shareholder resolution which is intended or appears to be intended to circumvent the proper application of the Listing Rules. The Company also confirms that its Articles of Association do not prevent the election and re-election of Independent Directors to be conducted in accordance with the election provisions set out in Listing Rule 9.2.2ER and Listing Rule 9.2.2FR.

There are no material contracts with controlling shareholders, except as set out above and disclosed in the Directors' Remuneration Report on pages 37 to 55.

No Director is entitled to any compensation for loss of office on a takeover or change of control of the Company. Details of employee share schemes are set out in note 5 to the financial statements.

Shares held by the Group ESOT abstain from voting.

### Share capital

The rights and obligations relating to the Company's shares are set out in the Articles of Association. The Articles of Association can be requested from the Company Secretary at the Company's registered office.

There are no restrictions on the transfer of ordinary shares in the capital of the Company other than those which may be imposed by law from time to time. In accordance with the Disclosure and Transparency Rules, certain employees are required to seek approval to deal in the Company's shares. TalkTalk is in the process of implementing the EU Market Abuse Regulation, which comes into force on 3 July 2016. The Company is not aware of any agreements between shareholders that may result in restrictions on the transfers of securities and/or voting rights.

There is a general right of the Company to purchase its own shares, as set out in Article 16 of the Company's Articles of Association.

In addition, at the AGM in 2015, the Company was granted the right to acquire 95, 561, 546 shares. This right expires on the date of the 2016 AGM or 22 October 2016 (whichever is sooner).

The Articles of Association may be changed by special resolution.

Details in the movements in authorised and issued share capital during the period are provided in notes 21 and 22 to the financial statements.

### Appointment of Directors

The rules relating to the appointment and/or removal of Directors are contained in Section O of the Company's Articles of Association.

The powers of the Directors are set out in the Company's Articles of Association.

### Property, plant and equipment

Movements in property, plant and equipment are set out in note 12 to the financial statements.

### Dividends

The Company may, by resolution in a general meeting, declare dividends in accordance with the respective rights of the members, but no dividend can exceed the amount recommended by the Board.

### Significant shareholdings

At 15 April 2016, the Company had been notified of the following interests in the Company's shares:

| Name | Number of shares | % of share capital |
|---|---|---|
| Sir Charles Dunstone | 294,059,396 | 30.77 |
| Capital Research Global Investors | 136,194,891 | 14.25 |
| David Ross | 116,160,528 | 12.16 |
| INVESCO Asset Management Limited | 112,064,228 | 11.73 |
| Alken Asset Management LLP | 46,586,057 | 4.87 |
| Jupiter Asset Management Ltd | 29,540,077 | 3.09 |

The total interests of the Directors are detailed in the Directors' Remuneration Report on pages 37 to 55.

### Directors' indemnities

Directors' liability insurance is provided for Directors.

### Equal opportunities

We celebrate diversity and have an equality policy, which ensures that everyone is provided with the same opportunities for employment, career development, training and promotion. As part of this policy, applications for employment by disabled persons are fully considered, bearing in mind the abilities of the applicant concerned. In the event of employees becoming disabled during employment a thorough process is followed and support provided (including income support insurance) to try to secure their employment.

### Modern slavery

We are committed to ensuring that there is no modern slavery or human trafficking in our supply chains or in any part of our business to acting ethically and with integrity in all our business relationships.

### Gender pay reporting

We are keen to ensure that employees are paid appropriately for the work that they do. We undertook a gender pay audit in the year ended 31 March 2016 and we intend to do so on an annual basis. We are committed to complying with the mandatory gender pay reporting regulations when they come into force in April 2018.

### Audit information

Each of the persons who is a Director at the date of approval of this Annual Report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of the information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

By order of the Board

**Tim Morris**
**Company Secretary**
12 May 2016

**TalkTalk Telecom Group PLC**
11 Evesham Street
London W11 4AR

# Directors' responsibility statement

The Directors are responsible for preparing the Annual Report, the Remuneration Report and the Group financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

Under Company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRS, as adopted by the EU, have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the Remuneration Report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Each of the Directors, whose names and functions are listed in the 'Other statutory information' section of the Annual Report confirm that, to the best of their knowledge:

- the Group financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

**Dido Harding**
**Chief Executive Officer**
12 May 2016

**Iain Torrens**
**Chief Financial Officer**
12 May 2016

# Financial statements

# Independent auditor's report

to the members of TalkTalk Telecom Group PLC

| | |
|---|---|
| **Opinion on financial statements of TalkTalk Telecom Group PLC** | **In our opinion:**<br>• **the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2016 and of the Group's profit for the year then ended;**<br>• **the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;**<br>• **the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and**<br>• **the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.**<br>The financial statements comprise the Group income statement, the Group statement of comprehensive income, the Group and Parent Company balance sheets, the Group and Parent Company cash flow statements, the Group and Parent Company statements of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006. |
| **Separate opinion in relation to IFRSs as issued by the IASB** | As explained in note 1 to the Group financial statements, in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, the Group has also applied IFRSs as issued by the International Accounting Standards Board (IASB).<br>In our opinion the Group financial statements comply with IFRSs as issued by the IASB. |
| **Going concern and the Directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group** | As required by the Listing Rules we have reviewed the Directors' statement regarding the appropriateness of the going concern basis of accounting contained within page 11 to the financial statements and the Directors' statement on the longer-term viability of the Group contained within the corporate governance statement on page 33.<br>We have nothing material to add or draw attention to in relation to:<br>• the Directors' confirmation on page 20 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;<br>• the disclosures on pages 20-23 that describe those risks and explain how they are being managed or mitigated;<br>• the Directors' statement on page 11 about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and<br>• the Directors' explanation on page 33 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.<br>We agreed with the Directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern. |
| **Independence** | We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and we confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards. |
| **Our assessment of risks of material misstatement** | The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team. |

| Risk | How the scope of our audit responded to the risk |
|---|---|
| **Revenue recognition**<br>Revenue represents a material balance of £1,835m consisting of a high volume of individually low value transactions and we have identified the following types of transactions and assertions related to revenue recognition which give rise to key risks:<br>• the completeness of revenue recorded as a result of the reliance on output of the billing systems;<br>• the accuracy and completeness of revenue recognised on transactions which are outside the normal billing process, which by their nature carry a higher level of management judgement; and<br>• the appropriateness of the allocation of the total transaction value between multiple elements in a bundled transaction.<br>See note 1 to the financial statements for revenue recognition policy. | We involved our IT specialists to test the operating effectiveness of automated and non-automated controls over the customer billing systems. Our tests assessed the controls in place to ensure all services supplied to customers are input into and processed through the billing systems.<br>This enabled us to take a controls reliance approach over billing systems accounting for over 95% of total Group revenue. We subsequently applied a combination of substantive analytical review procedures and tests of detail to obtain assurance over the validity and completeness of the reported output of these systems.<br>We performed substantive testing on a sample of non-systematic adjustments which are outside of the normal billing process and therefore carry higher levels of management judgement. These included revenue deferrals and the write-back to the income statement of credits applied to customer accounts. This included agreeing a sample of items to supporting evidence to determine whether in line with Group policies as well as analytical review to understand the movement's year on year.<br>We have assessed the appropriateness of the revenue recognition policy and also performed substantive testing to assess whether the fair value of elements delivered up front exceeds amounts billable and therefore the unbundling accounting policy has been appropriately applied. |
| **Supplier income**<br>As disclosed in note 1 to the financial statements, the Group periodically receives commercial income, bonuses or other rebates from suppliers. As per note 3 the amount received in the current year was £13m. There is a risk that these are incorrectly accounted for or recognised in the wrong accounting period. | We held discussions with the relationship managers for the major suppliers across the Group and reviewed supplier accounts to identify significant credits from suppliers. For significant credit items we reviewed the relevant agreements to understand the terms and conditions associated with the transaction and associated commercial rationale. Based on our review of the agreements, we have challenged management's recognition of the accounting treatment of credits recognised from suppliers including re-calculations of amounts recognised. |
| **Disclosure of exceptional items and the presentation of adjusted measures in the financial statements**<br>The disclosure of exceptional items and their presentation on the face of the income statement remains to be a significant audit risk given the level of management judgement involved. The Group is part way through a number of significant projects (such as 'Making TalkTalk Simpler') which are multi-phase projects spanning a number of years and consequently we consider there is significant management judgement in determining whether those costs or projects are exceptional based on the Group's policy or are, in substance, 'business as usual' and therefore should be recognised in underlying earnings.<br>The nature of these costs has been defined in note 9 to the financial statements. | In addition to understanding the composition of exceptional items and agreeing a sample of items to supporting documentation, we have challenged management's rationale for the presentation of items within the income statement as exceptional, particularly around the areas of higher judgement such as migration costs, internal labour, and costs for implementing operating efficiencies to determine whether the costs recognised as exceptional meet the criteria of the accounting policy for such items defined by the Group within note 9. This includes assessing the incremental nature of the costs, the extent to which the costs are non-recurring, whether they are specific to individual projects and considering whether they should be classified as part of underlying operations.<br>Our work has also included a review, on a sample basis, of items included within the income statement to identify income and expenses which may be exceptional by nature but not separately identified. This included consideration of credit balances within underlying results. |

# Independent auditor's report continued

to the members of TalkTalk Telecom Group PLC

| Risk | How the scope of our audit responded to the risk |
|---|---|
| **Cyber attack impacts**<br>In October 2015, the Company website was subject to a significant and sustained cyber attack. Immediately following the incident, the Group incurred additional costs, £42m of which management has presented as exceptional (see note 9). We consider there to be significant judgement in determining whether some of these costs meet the Group's definition of exceptional items. Particular areas of focus included the cost of 'goodwill gestures' given to customers, increased call centre costs, utilisation of external security consultants and the consequent impact on other internal projects.<br>The incident also resulted in increased customer churn, which has impacted Group results for the second half of the year and future cash flows. Key assumptions underpinning future cash flows have been reassessed in light of this to define the impact on headroom against committed facilities. | We have reviewed the incident reports prepared by external consultants and considered the implications for our audit approach, particularly around our reliance on IT controls for material billing systems.<br>We have challenged management's rationale for the presentation of items within the income statement as exceptional, particularly determining whether costs were incremental to the Group and as a direct result of the cyber attack. This included challenge around areas of higher judgement, including incremental call centre and consumer credit costs and the impact on system implementation delays.<br>As part of our impairment testing and going concern reviews, we have considered management's forecasts in the light of the cyber attack and have considered the impact of increased customer churn and related costs. |
| **Carrying value of goodwill**<br>As disclosed in note 11 to the financial statements the carrying value of goodwill on the Group balance sheet as at 31 March 2016 is £495m. Management is required to undertake an impairment review annually or, if more frequent, whenever there is an indication that the asset may be impaired. This review incorporates judgements based on assumptions of future cash flows, including assumptions around revenue growth, margins and forecast cash flows, the selection of appropriate discount rates and the assessment of the Group's cash generating units. The assumptions underpinning the forecasts have all been reviewed in light of the recent cyber attack on the Company's website and the impact this could have on future cash flows. | We challenged management's assumptions used in the impairment model for goodwill and intangible assets, including the determination of cash generating units, the forecast cash flow projections for each cash generating unit and the discount rates applied. In making this assessment of the cash flow projections we assessed historical forecasting accuracy and compared forecast profit margins to historical margins and benchmarked the discount rate and growth rates employed to available market data. We critically assessed management's position as to whether or not a reasonably possible change to key operating assumptions could result in an impairment. In doing so we considered the sensitivity of the asset valuations to these assumptions, in particular changes to the long term growth rate assumed. We assessed whether the forecasts being used for these purposes had been updated for the impacts of the cyber attack. We used our specialist team to determine whether the discount rate used in the calculations was appropriate. We also considered the appropriateness of the related disclosures set out in note 11 to the financial statements. |
| **Recoverability of deferred tax assets**<br>As disclosed in note 7 to the financial statements the Group has significant unused tax losses of £650m for which the utilisation depends upon a complex allocation of the Group's profits to particular loss pools. The recognition of deferred tax assets (and provisions against any unrecoverable portion) is a significant management judgement.<br>As above, the recent cyber attack on the Company's website has had an impact on future cash flows and profitability which has also required consideration when assessing the recoverability of deferred tax assets against future profits. | We have used our in-house tax specialists to challenge management's approach to the deferred tax recognised in the year including the decision to continue to use a ten year forecast for the recognition of deferred tax assets in respect of losses. We have considered if the forecasts being used for these purposes have been updated to align to the Group forecast which has been updated to include the impact of the cyber attack in the year.<br>We have considered ongoing correspondence with HMRC and the impact that this has on any judgements and the accounting treatment applied by management. |

Last year our report included acquisition accounting as a risk which is not included in our report this year. There were material acquisitions in the prior year giving rise to cumulative goodwill of £11m and other intangibles assets of £43m. The Group has not made any material acquisitions in the current year and therefore this risk is no longer relevant for our audit report.

The description of risks above should be read in conjunction with the significant issues considered by the Audit Committee discussed on page 35.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

## Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Group to be £4.8m, which is approximately 5% of adjusted pre-tax profit. Pre-tax profit has been adjusted by removing the effect of exceptional items. This has been used as a base as it is a key performance indicator of the Group and is of particular interest to shareholders. This is a change of approach from 2015, where we used a materiality of £6m which was around 7.3% of adjusted pre-tax profit. The prior year materiality was set by blending revenue and profit metrics. This approach was taken to make allowance for the impact of subscriber acquisition costs related to TV customers which reduced prior year earnings.

We agreed with the Audit Committee that we would report all audit differences in excess of £96,000 (2015: £120,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

## An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we focused our Group audit scope primarily on the TalkTalk Consumer and TalkTalk Business operating units. Each of these were subject to a full audit and represent over 95% (2015: over 95%) of the Group's total assets and revenues. Specific focused audit work was performed over Group functions, including those covering treasury and taxation. Our audit work at each division was executed at levels of materiality which were lower than Group materiality.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit.

## Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Matters on which we are required to report by exception

**Adequacy of explanations received and accounting records**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

**Directors' remuneration**

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

**Corporate Governance Statement**

Under the Listing Rules we are also required to review part of the Corporate Governance Statement relating to the Company's compliance with certain provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

# Independent auditor's report continued

to the members of TalkTalk Telecom Group PLC

## Matters on which we are required to report by exception continued

**Our duty to read other information in the Annual Report**

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

**Respective responsibilities of directors and auditor**

As explained more fully in the Directors' Responsibilities Statement on page 38, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Sharon Thorne FCA (Senior statutory auditor)**
**for and on behalf of Deloitte LLP**
**Chartered Accountants and Statutory Auditor**
**London, United Kingdom**
12 May 2016

# Consolidated income statement

For the year ended 31 March 2016

| | | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|---|
| | Notes | **Headline - before amortisation of acquisition intangibles and exceptional items £m** | **Non-operating amortisation and exceptional items £m** | **Statutory - after amortisation of acquisition intangibles and exceptional items £m** | Headline - before amortisation of acquisition intangibles and exceptional items £m | Non-operating amortisation and exceptional items £m | Statutory - after amortisation of acquisition intangibles and exceptional items £m |
| **Revenue** | 2 | 1,838 | (3) | 1,835 | 1,795 | – | 1,795 |
| Cost of sales | | (845) | – | (845) | (815) | – | (815) |
| **Gross profit** | | 993 | (3) | 990 | 980 | – | 980 |
| Operating expenses excluding amortisation and depreciation | | (733) | (80) | (813) | (735) | (46) | (781) |
| **EBITDA** | 9 | 260 | (83) | 177 | 245 | (46) | 199 |
| Depreciation | 3, 12 | (72) | – | (72) | (78) | (5) | (83) |
| Amortisation | 3, 11 | (49) | (10) | (59) | (42) | (12) | (54) |
| Share of results of joint ventures | 14 | (8) | – | (8) | (8) | – | (8) |
| **Operating profit** | 3, 9 | 131 | (93) | 38 | 117 | (63) | 54 |
| Net finance costs | 6 | (24) | – | (24) | (22) | – | (22) |
| **Profit before taxation** | 9 | 107 | (93) | 14 | 95 | (63) | 32 |
| Taxation | 7 | (28) | 16 | (12) | (19) | 59 | 40 |
| **Profit for the year attributable to the owners of the Company** | 9 | 79 | (77) | 2 | 76 | (4) | 72 |
| **Earnings per share** | | | | | | | |
| Basic | 10 | | | 0.2p | | | 7.8p |
| Diluted | 10 | | | 0.2p | | | 7.7p |

| | 2016 | 2015 |
|---|---|---|
| **Statutory operating profit** | 38 | 54 |
| Adjusted for: | | |
| Non-operating amortisation | 10 | 12 |
| Exceptional items | 83 | 51 |
| **Headline operating profit** | 131 | 117 |

The accompanying notes are an integral part of this consolidated income statement. All amounts relate to continuing operations.

# Consolidated statement of comprehensive income

For the year ended 31 March 2016

| | Notes | 2016 £m | 2015 £m |
|---|---|---|---|
| **Profit for the year attributable to the owners of the Company** | | 2 | 72 |
| **Other comprehensive income** | | | |
| Items that may be reclassified to profit or loss: | | | |
| Gains/(losses) on a hedge of a financial instrument | 19 | 2 | (5) |
| Currency translation differences | | 1 | (1) |
| **Total other comprehensive income/(expense)** | | 3 | (6) |
| **Total comprehensive income** | | 5 | 66 |

The accompanying notes are an integral part of this consolidated statement of comprehensive income. All amounts relate to continuing operations.

# Consolidated balance sheet

As at 31 March 2016

| | Notes | **2016 £m** | 2015 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Goodwill | 11 | **495** | 490 |
| Other intangible assets | 11 | **227** | 178 |
| Property, plant and equipment | 12 | **302** | 290 |
| Investment in joint venture | 14 | **9** | 10 |
| Trade and other receivables | 14 | **3** | – |
| Derivative financial instruments | 19 | **18** | 11 |
| Deferred tax assets | 7 | **115** | 130 |
| | | **1,169** | 1,109 |
| **Current assets** | | | |
| Inventories | 15 | **57** | 31 |
| Trade and other receivables | 16 | **294** | 313 |
| Current income tax receivable | | **3** | 1 |
| Cash and cash equivalents | 18 | **10** | 10 |
| | | **364** | 355 |
| **Total assets** | | **1,533** | 1,464 |
| **Current liabilities** | | | |
| Trade and other payables | 17 | **(563)** | (516) |
| Borrowings | 18 | **(25)** | – |
| Provisions | 20 | **(18)** | (34) |
| | | **(606)** | (550) |
| **Non-current liabilities** | | | |
| Borrowings | 18 | **(684)** | (615) |
| Derivative financial instruments | 19 | **(1)** | (1) |
| Provisions | 20 | **(11)** | (1) |
| | | **(696)** | (617) |
| **Total liabilities** | | **(1,302)** | (1,167) |
| **Net assets** | | **231** | 297 |
| **Equity** | | | |
| Share capital | 21 | **1** | 1 |
| Share premium | 22 | **684** | 684 |
| Translation reserve | 22 | **(64)** | (65) |
| Demerger reserve | 22 | **(513)** | (513) |
| Retained earnings and other reserves | 22 | **123** | 190 |
| **Total equity** | | **231** | 297 |

The accompanying notes are an integral part of this consolidated balance sheet.

These financial statements were approved by the Board on 12 May 2016. They were signed on its behalf by:

**D Harding**
**Chief Executive Officer**

**I Torrens**
**Chief Financial Officer**

# Consolidated cash flow statement

For the year ended 31 March 2016

| | Notes | 2016 £m | 2015 £m |
|---|---|---|---|
| **Operating activities** | | | |
| Operating profit | 3 | 38 | 54 |
| Share-based payments | 5 | 5 | 4 |
| Depreciation | 3, 12 | 72 | 83 |
| Amortisation of other operating intangible fixed assets | 3, 11 | 49 | 42 |
| Amortisation of acquisition intangibles | 11 | 10 | 12 |
| Share of losses of joint venture | 14 | 8 | 8 |
| Profit on disposal of property, plant and equipment | 3 | – | (3) |
| Profit on disposal of subsidiaries and customer bases | 13 | – | (5) |
| **Operating cash flows before movements in working capital** | | 182 | 195 |
| Decrease/(increase) in trade and other receivables | | 15 | (44) |
| Increase in inventory | | (26) | (7) |
| Increase in trade and other payables | | 17 | 26 |
| (Decrease)/increase in provisions | | (6) | 26 |
| **Cash generated from operations** | | 182 | 196 |
| Income taxes paid | | – | (2) |
| **Net cash flows generated from operating activities** | | 182 | 194 |
| **Investing activities** | | | |
| Acquisition of subsidiaries and joint ventures, net of cash acquired | 13, 14 | (14) | (38) |
| Disposal of subsidiaries and customer bases | 13 | 2 | – |
| Investment in intangible assets | 11 | (106) | (49) |
| Investment in property, plant and equipment | | (72) | (67) |
| Disposal of property, plant and equipment | | 12 | 4 |
| **Cash flows used in investing activities** | | (178) | (150) |
| **Financing activities** | | | |
| Settlement of Group ESOT shares | | 2 | 2 |
| Net sale of own shares | | 61 | – |
| Drawdown of borrowings | 23 | 90 | 109 |
| Interest paid | | (22) | (22) |
| Dividends paid | 8 | (135) | (116) |
| **Cash flows used in financing activities** | | (4) | (27) |
| **Net increase in cash and cash equivalents** | | – | 17 |
| Cash and cash equivalents at the start of the year | | 10 | (7) |
| **Cash and cash equivalents at the end of the year** | 18 | 10 | 10 |

The accompanying notes are an integral part of this consolidated cash flow statement.

# Consolidated statement of changes in equity

For the year ended 31 March 2016

| | Note | Share capital £m | Share premium £m | Translation reserve £m | Demerger reserve £m | Retained earnings and other reserves £m | Total equity £m |
|---|---|---|---|---|---|---|---|
| At 1 April 2014 | | 1 | 684 | (64) | (513) | 239 | 347 |
| **Profit for the year** | | – | – | – | – | 72 | 72 |
| **Other comprehensive income** | | | | | | | |
| Items that may be reclassified to profit or loss: | | | | | | | |
| Loss on hedge of a financial instrument | | – | – | – | – | (5) | (5) |
| Currency translation differences | | – | – | (1) | – | – | (1) |
| **Total other comprehensive expense** | | – | – | (1) | – | (5) | (6) |
| **Total comprehensive income** | | – | – | (1) | – | 67 | 66 |
| **Transactions with the owners of the Company** | | | | | | | |
| Share-based payments reserve credit | 5 | – | – | – | – | 4 | 4 |
| Share-based payments reserve debit | | – | – | – | – | (3) | (3) |
| Settlement of Group ESOT | | – | – | – | – | 2 | 2 |
| Equity dividends | 8 | – | – | – | – | (116) | (116) |
| Taxation of items recognised directly in reserves | | – | – | – | – | (3) | (3) |
| At 31 March 2015 | | 1 | 684 | (65) | (513) | 190 | 297 |
| **Profit for the year** | | – | – | – | – | 2 | 2 |
| **Other comprehensive income** | | | | | | | |
| Items that may be reclassified to profit or loss: | | | | | | | |
| Gain on hedge of a financial instrument | | – | – | – | – | 2 | 2 |
| Currency translation differences | | – | – | 1 | – | – | 1 |
| **Total other comprehensive income** | | – | – | 1 | – | 2 | 3 |
| **Total comprehensive income** | | – | – | 1 | – | 4 | 5 |
| **Transactions with the owners of the Company** | | | | | | | |
| Share-based payments reserve credit | 5 | – | – | – | – | 5 | 5 |
| Share-based payments reserve debit | | – | – | – | – | (1) | (1) |
| Sale of own shares | 22 | – | – | – | – | 61 | 61 |
| Settlement of Group ESOT | | – | – | – | – | 2 | 2 |
| Equity dividends | 8 | – | – | – | – | (135) | (135) |
| Taxation of items recognised directly in reserves | | – | – | – | – | (3) | (3) |
| **At 31 March 2016** | | 1 | 684 | (64) | (513) | 123 | 231 |

The accompanying notes are an integral part of this consolidated statement of changes in equity.

# Notes to the consolidated financial statements

## 1. Accounting policies and basis of preparation

**Basis of preparation**

TalkTalk Telecom Group PLC is incorporated and domiciled in England and Wales under the Companies Act 2006. The Company's shares are listed on the London Stock Exchange. The registered office of the Company is 11 Evesham Street, London W11 4AR.

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union (EU) and as applied in accordance with the provisions of the Companies Act 2006. These financial statements therefore comply with Article 4 of the European Union International Accounting Standard regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial instruments and investments. The financial statements are presented in Sterling, rounded to the nearest million, because that is the currency of the principal economic environment in which the Group operates.

**Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Company, entities controlled by the Company (its subsidiaries) and entities which are joint ventures accounted for using the equity method made up to 31 March each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or sold during the year are included from or to the date on which control passed to or was relinquished by the Group. Intercompany transactions and balances between subsidiaries are eliminated on consolidation.

Where necessary, adjustments are made to the financial statements of subsidiaries and the results of joint ventures to bring accounting policies in line with those used by the Group.

**Going concern**

The financial statements have been prepared on the going concern basis. Details of the considerations undertaken by the Directors in reaching this conclusion are set out on page 11 within the Chief Financial Officer's Statement.

**Viability statement**

Details of the considerations undertaken by the Directors in reaching their conclusions are set out on page 33 within the Corporate Governance section.

**Accounting policies**

The Group's principal accounting policies, which relate to the financial statements as a whole, are set out below. Where an accounting policy is specific to one note, the policy is described in the note to which it relates. This section also shows new EU-endorsed accounting standards, amendments and interpretations, whether these are effective in the current or later years. In both cases it is explained how they are expected to impact the performance of the Group.

**Revenue**

Revenue is stated net of VAT and other sales-related taxes and represents the gross inflow of economic benefit generated from the provision of fixed line, TV and mobile telecommunications services. All such revenue is recognised as the services are provided:

- line rental is recognised in the period to which it relates;
- voice and broadband subscriptions are recognised in the period to which they relate;
- usage including voice and TV content is recognised in the period in which the customer takes the service;
- promotional discounts and credits are amortised on a straight line basis over the minimum contract period subject to an adjustment for in-contract churn; and
- data service solutions and other service contracts are recognised as the Group fulfils its performance obligations.

Revenue is measured at fair value of the consideration received or receivable. When the Group sells a number of products within a bundled transaction, the total consideration from the arrangement is allocated to each element based on their relative fair values. Management applies judgement in determining the amount of revenue the Group recognises for delivered elements. This is limited to the amounts billed for that element.

**Subscriber acquisition costs**

Subscriber acquisition costs include both third party costs of recruiting and retaining new customers as well as device costs. Certain subscriber acquisition costs relate to revenue share arrangements with third parties. These are expensed as incurred.

## 1. Accounting policies and basis of preparation continued

### Foreign currency translation and transactions

Material transactions in foreign currencies are hedged using forward purchases or sales of the relevant currencies and are recognised in the financial statements at the exchange rates obtained. Unhedged transactions are recorded at the exchange rate on the date of the transaction. Hedge accounting as defined by IAS 39 'Financial Instruments: Recognition and Measurement' has been applied in the current and preceding financial year by marking to market the relevant financial instruments at the balance sheet date and recognising the gain or loss through other comprehensive income in respect of cash flow hedges.

The principal exchange rates against UK Sterling used in these financial statements are as follows:

| | Average | | Closing | |
|---|---|---|---|---|
| | **2016** | 2015 | **2016** | 2015 |
| Euro | **1.36** | 1.29 | **1.26** | 1.38 |
| United States Dollar | **1.50** | 1.61 | **1.44** | 1.49 |

### Leases

Rental payments under operating leases are charged to the income statement on a straight line basis over the period of the lease, even where payments are not made on such a basis. Lease incentives and rent free periods are amortised through the income statement over the period of the lease term.

Gains or losses from sale and leaseback transactions are deferred over the life of the new lease to the extent that the rentals are considered to be above or below market rentals. The remaining gain or loss is recognised within operating expenses in the year in which the sale is completed.

### Financial instruments

Financial assets and financial liabilities, in respect of financial instruments, are recognised in the Group balance sheet when the Group becomes a party to the contractual provisions of the instrument.

#### Trade and other receivables

Trade receivables and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest rate method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short term receivables when the recognition of interest would be immaterial.

#### Rebates receivable from suppliers

Occasionally, the Group enters into agreements with certain suppliers for rebates on the cost of goods purchased. Judgement is applied by management in these circumstances to ensure that the rebate is recognised over the appropriate financial period.

Rebates from suppliers in the year related to renegotiated contract rates and compensation received under existing contracts. Where these amounts relate to historical transactions, negotiated in the current year, they are recognised in the current year income statement. Where they relate to future transactions, negotiated in the current year, they are recognised in accordance with the contractual terms.

#### Cash and cash equivalents

Cash and cash equivalents consist of cash at bank and in hand and bank deposits.

#### Trade payables

Trade payables are other financial liabilities initially measured at fair value and subsequently measured at amortised cost.

#### Financial liabilities and equity instruments

Financial liabilities and equity instruments issued by the Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities and includes no obligation to deliver cash or other financial assets. The accounting policies adopted for specific financial liabilities and equity instruments are set out below.

#### Borrowings

Borrowings represent committed and uncommitted bank loans, US Private Placement Notes and bank overdrafts. These are initially measured at net proceeds and are subsequently measured at amortised cost, using the effective interest rate method.

Bank fees and legal costs associated with the securing of external financing are capitalised and amortised over the term of the relevant facility. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

# Notes to the consolidated financial statements continued

## 1. Accounting policies and basis of preparation continued

**Financial instruments** continued

### Equity instruments

Equity instruments issued by the Group are recorded at the proceeds received, net of direct issuance costs.

Shares in the Company held by the Group ESOT are shown as a reduction in shareholders' funds. Other assets and liabilities held by the trust are consolidated with the assets of the Group.

### Derivative financial instruments and hedge accounting

The Group's activities expose it to the financial risks of changes in foreign exchange rates and interest rates. The use of financial derivatives is governed by the framework approved by the Board, which provides written principles on the use of financial derivatives consistent with the Group's risk management strategy. Changes in values of all derivatives of a financing nature are included within investment income and financing costs in the income statement. The Group does not use derivative financial instruments for speculative purposes.

Derivative financial instruments are initially measured at fair value on the contract date and are subsequently remeasured to fair value at each reporting date.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting, or the Company chooses to end the hedging relationship.

### Cash flow hedges

The Group uses derivative instruments (primarily interest rate swaps) to manage its interest rate risk. The Group designates these as cash flow hedges. The effective portion of changes in the fair value of these instruments is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

### Measurement

The financial instruments included on the Group balance sheet are measured at fair value or amortised cost. The measurement of this fair value can in some cases be subjective and can depend on the inputs used in the calculations. The different valuation methods are called 'hierarchies' and are described below:

- Level 1: Fair values measured using quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: Fair values measured using inputs, other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly; and
- Level 3: Fair values measured using inputs for the asset or liability that are not based on observable market data.

**Critical accounting judgements and key sources of estimation uncertainty**

The preparation of financial statements requires management to exercise judgement in applying the Group's accounting policies. Estimates and assumptions used in the preparation of the financial statements are continually reviewed and revised as necessary. Whilst every effort is made to ensure that such estimates and assumptions are reasonable, by their nature they are uncertain, and as such changes in estimates and assumptions may have a material impact.

The areas involving the most sensitive estimates and assumptions that are significant to the financial statements are set out in more detail in the related notes:

- going concern and viability statement (pages 11 and 33 respectively);
- rebates receivable from suppliers (note 1);
- revenue recognition for bundled transactions (note 1);
- taxation (note 7);
- exceptional items (note 9);
- impairment of goodwill (note 11);
- valuation of intangibles (note 11); and
- impairment of assets (notes 11 and 12).

## 1. Accounting policies and basis of preparation continued

### Application of significant new or amended EU-endorsed accounting standards

There are no new or revised standards and interpretations that have had a material impact on the Group during the year.

### Future accounting developments

At the date of authorisation of these financial statements, there were a number of significant standards and interpretations that have not been applied in these financial statements, these were in issue, but not yet effective (and in some cases had not yet been adopted by the EU).

The Directors expect that the following standards will have material impact on the financial statements of the Group in future periods:

- IFRS 9 'Financial Instruments', impacting both the measurement and disclosure of financial instruments. The effective date of these changes for the Group is 1 April 2018.
- IFRS 15 'Revenue from Contracts with Customers', impacting revenue recognition, related costs and disclosures. The effective date of these changes for the Group is 1 April 2017. An evaluation project has commenced to review and implement this accounting development.
- IFRS 16 'Leases', impacting lease recognition. The effective date of these changes for the Group is 1 April 2019.

Beyond the information above, it is not practicable to provide a reasonable estimate of the effect of these standards until a detailed review has been concluded.

## 2. Segmental reporting

### Accounting policy

IFRS 8 'Operating Segments' requires the segmental information presented in the financial statements to be that used by the chief operating decision maker (CODM) to evaluate the performance of the business and decide how to allocate resources. The Group has identified the Board as its CODM. The Board considers the results of the business as a whole when assessing the performance of the business and making decisions about the allocation of resources. Accordingly the Group has one operating segment with all trading operations based in the United Kingdom.

| | **2016 £m** | 2015 £m |
|---|---|---|
| **Headline revenue** | 1,838 | 1,795 |
| **Headline EBITDA** | 260 | 245 |
| Depreciation | (72) | (78) |
| Amortisation of operating intangibles | (49) | (42) |
| Share of results of joint ventures | (8) | (8) |
| **Headline operating profit (note 9)** | 131 | 117 |
| Amortisation of acquisition intangibles | (10) | (6) |
| Exceptional items – Revenue | (3) | – |
| Exceptional items – Operating expenses excluding amortisation and depreciation | (80) | (46) |
| Exceptional items – Impairment loss(1) | – | (11) |
| **Statutory operating profit (note 9)** | 38 | 54 |

(1) Includes £6m of non-operating amortisation.

The Group's revenue is split by On-net, Off-net and Corporate products as this information is provided to the Group's CODM. On-net and Off-net comprise Consumer and Business customers that receive similar services.

| | **2016 £m** | 2015 £m |
|---|---|---|
| On-net | 1,399 | 1,333 |
| Corporate | 384 | 375 |
| Off-net | 55 | 87 |
| **Headline revenue** | 1,838 | 1,795 |

The Group has no material overseas operations; as a result, a split of revenue and total assets by geographical location has not been disclosed.

# Notes to the consolidated financial statements continued

### 3. Operating profit

Operating profit is stated after charging/(crediting):

| | 2016 £m | 2015 £m |
|---|---|---|
| Depreciation of property, plant and equipment | 72 | 78 |
| Amortisation of acquisition intangibles (note 9) | 10 | 6 |
| Amortisation of other operating intangible fixed assets | 49 | 42 |
| Profit on disposal of property, plant and equipment | – | (3) |
| Impairment loss recognised on trade receivables | 71 | 62 |
| Staff costs | 139 | 122 |
| Cost of inventories recognised in expenses | 72 | 115 |
| Rentals under operating leases | 100 | 95 |
| Supplier rebates(1) | (13) | (33) |
| Auditor's remuneration(2) | 1 | 1 |
| Exceptional items (note 9) | 83 | 46 |
| Exceptional items – Impairment loss (note 9) | – | 11 |

(1) Included within operating profit for the prior year is a credit of £20m to offset associated increased costs of £25m.

(2) A breakdown of auditor's remuneration is disclosed within the governance section on page 36.

### 4. Employee costs

The average number of employees (including Executive Directors) was:

| | 2016 Number | 2015 Number |
|---|---|---|
| Administration | 1,670 | 1,452 |
| Sales and customer management | 620 | 655 |
| | 2,290 | 2,107 |

The aggregate remuneration recognised in respect of these employees in the income statement comprised:

| | 2016 £m | 2015 £m |
|---|---|---|
| Wages and salaries | 115 | 102 |
| Social security costs | 15 | 12 |
| Other pension costs | 4 | 4 |
| | 134 | 118 |
| Share-based payments (note 5) | 5 | 4 |
| | 139 | 122 |

The Group provides various defined contribution pension schemes for the benefit of a significant number of its employees. These are charged to the income statement as they become payable in accordance with the rules of the schemes.

Compensation earned by key management personnel is analysed below. The key management personnel comprised the Board of Directors (see Directors' Remuneration Report on pages 37 to 55) and the Executive Committee.

| | 2016 £m | 2015 £m |
|---|---|---|
| Salaries and fees | 3.8 | 3.2 |
| Performance bonuses | 1.8 | 1.9 |
| Benefits | 0.1 | 0.2 |
| Pension costs | 0.2 | 0.2 |
| Share-based payments | 1.4 | 1.8 |
| Compensation for loss of office | – | 0.2 |
| | 7.3 | 7.5 |

## 5. Share-based payments

### Accounting policy

The Group issues equity settled share-based payments to certain employees and Executive Directors. Equity settled share-based payments are measured at fair value at the date of grant and expensed over the vesting period, based on an estimate of the number of shares that will eventually vest.

Fair value is measured by use of a dividend discount or binomial model for share-based payments with internal, non-market performance criteria (for example, EPS targets) and a Black Scholes or Monte Carlo model for those with external performance criteria (for example, TSR targets).

For schemes with non-market performance criteria, the number of options expected to vest is recalculated at each balance sheet date, based on expectations of performance against target and of leavers prior to vesting. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in reserves.

For schemes with market performance criteria, the number of options expected to vest is adjusted only for expectations of leavers prior to vesting. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in reserves.

If a scheme is cancelled, any remaining part of the fair value of the scheme is expensed immediately. If a scheme is forfeited, no further expense is recognised and any charges previously recognised are reversed.

Charges arise on loans that are provided to employees to fund the purchase of shares in the Group as part of long term incentive plans. To the extent to which the loans are not, in certain circumstances, repayable, the cost of such loans is expensed over the course of the relevant incentive plans. Charges are also recognised on loans provided to employees to settle personal tax liabilities. To the extent to which the loans are not, in certain circumstances, repayable, the cost of such loans is expensed.

### TalkTalk Telecom Group PLC schemes

TalkTalk Telecom Group PLC schemes are the Shareholder Value Plan (SVP), Discretionary Share Option Plan (DSOP), Save-As-You-Earn (SAYE) Scheme and Share Match Plan (SIP). Where applicable, the ESOT holds shares to settle these plans, based on the latest view of vesting.

In order to aid the user of the financial statements, the dilutive effect on EPS of each scheme has been presented. This has been calculated using an average share price for the financial year of £2.92 (2015: £3.00).

### Summary of share schemes

| **Year ended 31 March 2016** | **IFRS 2 charge £m** | **Dilutive effect millions** | **Options outstanding at the end of the year millions** |
|---|---|---|---|
| **TalkTalk Telecom Group PLC schemes** | | | |
| SVP – participation shares | 2 | 2 | – |
| DSOP – 2015 grant (FY16) | – | – | 2 |
| DSOP – 2014 grant (FY15) | 1 | 3 | 7 |
| DSOP – 2013 grant (FY14) | 1 | 2 | 4 |
| DSOP – 2012 grant (FY13) | – | 2 | 2 |
| DSOP – 2010 grant (FY11) | – | 1 | 2 |
| SAYE | 1 | 1 | 4 |
| **Total TalkTalk Telecom Group PLC schemes** | 5 | 11 | 21 |

| Year ended 31 March 2015 | IFRS 2 charge £m | Dilutive effect millions | Options outstanding at the end of the year millions |
|---|---|---|---|
| **TalkTalk Telecom Group PLC schemes** | | | |
| SVP – participation shares | 2 | 3 | – |
| DSOP – 2014 grant (FY15) | 1 | 3 | 8 |
| DSOP – 2013 grant (FY14) | – | 3 | 5 |
| DSOP – 2012 grant (FY13) | – | 4 | 8 |
| DSOP – 2010 grant (FY11) | – | 1 | 2 |
| SAYE | 1 | 1 | 5 |
| **Total TalkTalk Telecom Group PLC schemes** | 4 | 15 | 28 |

## 5. Share-based payments continued

**Summary of share schemes** continued

### (i) SVP

The SVP is a growth plan and not a share option plan operating under the Value Enhancement Scheme (VES) rules previously approved by shareholders. The SVP enables participants to share in up to 7% of any increase in the value of the Group over an opening market capitalisation of £2,941m based on a five business day average up to 3 June 2014. The awards are subject to the following performance conditions:

- at least a 7% compound annual increase (CAGR) in the market capitalisation of the Group from the above valuation over a three and four year period; and
- the Group's TSR outperforms the FTSE 250.

The performance conditions are measured over an initial performance period from 3 June 2014 to the date of announcement of the Group's FY17 annual results, after which a total of 60% of the options will vest. The remaining options are measured over a performance period from 3 June 2014 to the date of announcement of the Group's FY18 annual results. The Pool also has a maximum cap on incremental value equal to 2.75% of the total issued share capital of TalkTalk Telecom Group PLC at the date of each vesting.

There is a holding period on 100% of the PLC shares received in exchange for participation shares on vesting, of twelve months from each vesting date for Executive Directors. All other participants are required to hold 50% of the PLC shares received in exchange for participation shares on vesting for twelve months from each vesting date.

In FY15, the Company made awards in the SVP. No awards were made in the year ended 31 March 2016. The Group advanced loans to participants to enable them to purchase participation shares in TalkTalk Group Limited, the holding company of the Group's operating business. These loans are subject to a commercial rate of interest set by HMRC.

If an employee leaves the Group before the scheme vests, then the participation shares are forfeited for the value of the outstanding loan plus accrued interest.

A fair value exercise was conducted for the award using the Monte Carlo method with the total fair value of the participation shares granted totalling £6m.

A summary of the scheme is shown below:

| | Participation shares | |
|---|---|---|
| SVP – 2015 grant | **2016 Number million** | 2015 Number million |
| Outstanding at the beginning of the year | 17 | – |
| Granted during the year | – | 17 |
| Forfeited during the year | – | – |
| **Outstanding at the end of the year** | 17 | 17 |
| **Exercisable at the end of the year** | – | – |

### (ii) DSOP

In FY15 ('2014 grant') and FY16 ('2015 grant'), the Group granted eight million nil-priced share option awards and two million nil-priced share option awards respectively. These awards are subject to the following performance conditions:

- at least a 7% compound annual increase (CAGR) in the market capitalisation of the Group from the below valuation over the next three and four year periods; and
- the Group's TSR outperforms the FTSE 250.

The options are measured as follows:

- 2014 grant: a performance period from 3 June 2014 to 3 June 2017 vesting on announcement of the Group's FY17 annual results. A total of 60% of the vested options are exercisable from the vesting date, with the remaining 40% of options being exercisable twelve months later. Options are forfeited if an employee leaves the Group before the options vest, subject to the DSOP scheme rules.
- 2015 grant: a performance period from 11 September 2015 to 11 September 2018 vesting on 11 September 2018. The vested options are only exercisable twelve months following the vesting date. Options are forfeited if an employee leaves the Group before the options vest, subject to the DSOP scheme rules.

### 5. Share-based payments continued

**Summary of share schemes** continued

(ii) DSOP continued

In FY14 ('2013 grant'), the Group granted six million nil-priced share option awards subject to absolute TSR and EPS performance targets. The options are measured over a performance period to 31 March 2016 and will vest on the announcement of the Group's FY16 annual results. A total of 60% of the vested options are exercisable from the vesting date, with the remaining 40% of options being exercisable twelve months later. Options are forfeited if an employee leaves the Group before the options vest subject to the DSOP scheme rules. Awards are triggered within a range from 5% to 26% for compound annual growth of TSR and EPS. If the minimum performance requirement is met a total of 25% of the award will vest, with incremental thresholds at 40%, 70% and 100%.

The second and final tranche (40%) of the 2012 DSOP grant (in FY13) is exercisable on 12 May 2016. Options are forfeited if an employee leaves the Group before the options vest.

| | 2015 grant | | 2014 grant | | 2013 grant | | 2012 grant | | 2010 grant | |
|---|---|---|---|---|---|---|---|---|---|---|
| Number of share options outstanding | Number million | WAEP £ | Number million | WAEP £ | Number million | WAEP £ | Number million | WAEP £ | Number million | WAEP £ |
| Opening balance at 1 April 2014 | – | – | – | – | 6 | – | 10 | – | 2 | 1.27 |
| Granted during the year | – | – | 8 | – | – | – | – | – | – | – |
| Forfeited during the year | – | – | – | – | (1) | – | (2) | – | – | – |
| Closing balance at 31 March 2015 | – | – | 8 | – | 5 | – | 8 | – | 2 | – |
| Granted during the year | 2 | – | – | – | – | – | – | – | – | – |
| Exercised during the year | – | – | – | – | – | – | (2) | – | – | – |
| Forfeited during the year | – | – | (1) | – | (1) | – | (4) | – | – | – |
| **Closing balance at 31 March 2016**(1) | 2 | – | 7 | – | 4 | – | 2 | – | 2 | 1.27 |
| Number of share options exercisable | | | | | | | | | | |
| **As at 31 March 2015** | n/a | n/a | – | – | – | – | – | – | 2 | – |
| **As at 31 March 2016** | – | – | – | – | – | – | – | – | 2 | 1.27 |

| Valuation assumptions | 2015 grant | 2014 grant | 2013 grant | 2012 grant | 2010 grant |
|---|---|---|---|---|---|
| Valuation method | Monte Carlo | Monte Carlo | Monte Carlo | Monte Carlo | Monte Carlo |
| Share price (p) | 309 | 321 | 228 | 122 | 132 |
| Exercise price (p) | nil | nil | nil | nil | 127 |
| Expected volatility | 25.0% | 25.0% | 30.0% | 30.0% | 37.0% |
| Expected exercise (60%/40%) | 4 years | 3 and 4 years | 3 and 4 years | 3 and 4 years | 3 and 4 years |
| Risk free rate (3 years/4 years) | 1.67% | 1.27% and 1.67% | 0.50% and 0.80% | 0.60% | 3.40% |
| Expected dividend yield | 5.60% | 5.60% | 4.45% | 3.50% | 3.80% |
| Fair value of options granted (£m) | 1 | 4 | 3 | 3 | 9 |
| Weighted average remaining contractual life | 9.4 years | 8.2 years | 7.2 years | 5.9 years | 4.6 years |

(1) 2012 grant exercisable from 12 May 2016.

# Notes to the consolidated financial statements continued

## 5. Share-based payments continued

**Summary of share schemes** continued

### (iii) SAYE

The scheme permits the granting of options to employees linked to a bank SAYE contract for a term of three or five years. Contributions from UK employees range from £5 to £250 per month for schemes launched between 2010 and 2013 and between £5 and £500 per month for the 2014 scheme onwards. Options may be exercised at the end of the three or five year period at an exercise price determined at the invitation date. The scheme is available for a period each year for employees to join.

Exercise prices for the schemes are set out below:

| | |
|---|---|
| 2015 grant | 307p per share |
| 2014 grant | 240p per share |
| 2013 grant | 192p per share |
| 2012 grant | 123p per share |
| 2011 grant | 119p per share |
| 2010 grant | 102p per share |

| | **2016** | | 2015 | |
|---|---|---|---|---|
| | **Number million** | **WAEP £** | Number million | WAEP £ |
| Outstanding at the beginning of the year | 4 | 1.89 | 4 | 1.52 |
| Granted during the year | 2 | 3.07 | 2 | 2.40 |
| Exercised during the year | (1) | 1.19 | (1) | 1.21 |
| Forfeited during the year | (1) | 2.54 | (1) | 1.97 |
| **Outstanding at the end of the year** | 4 | 2.32 | 4 | 1.89 |
| **Exercisable at the end of the year** | – | – | – | – |

| | SAYE – 2015 grant |
|---|---|
| Valuation method | Black Scholes |
| Share price (p) | 386 |
| Exercise price (p) | 307 |
| Expected volatility | 35.7% |
| Expected exercise (years) | 3.9 |
| Risk free rate | 2.09% |
| Expected dividend yield | 3.57% |
| Fair value of options granted (£m) | 2.0 |
| Weighted average remaining contractual life | 1.9 years |

### (iv) Share Match Plan

The Group launched its first all-employee, HMRC-approved Share Match Plan (SIP) in June 2014, following the Remuneration Committee approval of this scheme in the year ended 31 March 2014. This enables eligible employees to purchase market-priced shares by entering into a partnership share agreement and holding such shares in trust for up to a five year period. The rules of the Plan allow an employee maximum contribution of £1,800 per annum, or in line with HMRC limits if these are increased. Approval for the TTG Share Match was granted by shareholders at the AGM on 24 July 2013.

The Remuneration Committee, at its discretion, may award matching and/or free shares to eligible participants. Matching shares may be granted up to a maximum ratio of two matching shares for each partnership share purchased by a participant. Free shares may be awarded up to a maximum value of £3,600 tax free per annum, or in line with HMRC limits if these are increased.

Currently the Group provides one matching share for each partnership share purchased by participating employees or Executive Directors. During the year ended 31 March 2016, the impact of the SIP on the Group's results was not material.

## 6. Net finance costs

Net finance costs are analysed as follows:

| | 2016 £m | 2015 £m |
|---|---|---|
| Interest on bank loans and overdrafts | 21 | 17 |
| Facility fees and similar charges | 3 | 5 |
| | 24 | 22 |

During the year ended 31 March 2016 and 2015 the impact of finance income was not material.

In FY16, the Group signed two new revolving credit facilities. Arrangement fees of £1m were paid and are amortised over the life of the facilities. In FY15, the Group refinanced its term loan and revolving credit facility with bank debt and US Private Placement Notes and paid £5m in respect of arrangement and legal fees. The fees are being amortised over the expected life of the loan and notes and are included within facility fees and similar charges above. The average interest rate in the year was 3.10% (2015: 3.00%).

## 7. Taxation

### Accounting policy

Current tax, including UK corporation tax and overseas tax, is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is provided on temporary differences between the carrying amount of an asset or liability in the balance sheet and its tax base.

Deferred tax liabilities represent tax payable in future periods in respect of taxable temporary differences. Deferred tax assets represent tax recoverable in future periods in respect of deductible temporary differences, and the carry-forward of unused tax losses and credits. Deferred tax is determined using the tax rates that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Current and deferred tax is recognised in the income statement except where it relates to an item recognised directly in reserves, in which case it is recognised directly in reserves.

Deferred tax assets and liabilities are offset where there is a legal right to do so in the relevant jurisdictions.

### Critical judgements in applying the Group's accounting policy

The extent to which tax losses can be utilised depends on the extent to which taxable profits are generated in the relevant jurisdictions for the foreseeable future, and on the tax legislation then in force, and as such the value of associated deferred tax assets is uncertain.

### Tax – income statement

The tax charge/(credit) comprises:

| | 2016 £m | 2015 £m |
|---|---|---|
| **Current tax:** | | |
| UK corporation tax | – | – |
| Adjustments in respect of prior years: | | |
| UK corporation tax | (1) | – |
| UK corporation tax – exceptional credit | – | (14) |
| Total current tax credit | (1) | (14) |
| **Deferred tax:** | | |
| Origination and reversal of timing differences | 7 | – |
| Origination and reversal of timing differences – exceptional credit | – | (29) |
| Effect of change in tax rate | 6 | 1 |
| Adjustments in respect of prior years – deferred tax (credit)/charge | (3) | 4 |
| Adjustments in respect of prior years – exceptional charge/(credit) | 3 | (2) |
| Total deferred tax | 13 | (26) |
| **Total tax charge/(credit)** | 12 | (40) |

# Notes to the consolidated financial statements continued

## 7. Taxation continued

**Tax – income statement** continued

The tax charge on Headline earnings for the year ended 31 March 2016 was £28m (2015: £19m), representing an effective tax rate on pre-tax profits of 26% (2015: 20%). The tax charge on statutory earnings for the year ended 31 March 2016 was £12m (2015: credit of £40m). The reconciliation between the Headline and statutory tax charge is shown in note 9.

The principal differences between the tax charge and the amount calculated by applying the standard rate of UK corporation tax of 20% (2015: 21%) to the profit before taxation are as follows:

| | **2016 £m** | 2015 £m |
|---|---|---|
| Profit before taxation | 14 | 32 |
| Tax at 20% (2015: 21%) | 3 | 7 |
| Items attracting no tax relief or liability | 1 | 1 |
| Effect of change in tax rate | 6 | 1 |
| Adjustments in respect of prior years | (3) | 4 |
| Adjustments in respect of prior years – exceptional charge/(credit) | 3 | (16) |
| Movement in recognised tax losses during the year | 3 | – |
| Movement in unrecognised tax losses during the year | (1) | (8) |
| Movement in unrecognised tax losses during the year – exceptional credit | – | (29) |
| **Total tax charge/(credit) through income statement** | 12 | (40) |

**Tax – retained earnings and other reserves**

Tax on items recognised directly in retained earnings and other reserves is as follows:

| | **2016 £m** | 2015 £m |
|---|---|---|
| Total tax charge/(credit) through income statement | 12 | (40) |
| Deferred tax charge recognised directly in retained earnings and other reserves | 3 | 3 |
| **Total tax charge/(credit) through retained earnings and other reserves** | 15 | (37) |

The deferred tax charge recognised directly in retained earnings and other reserves for the years ended 31 March 2016 and 31 March 2015 relates to share-based payments.

**Tax – balance sheet**

The deferred tax assets recognised by the Group and movements thereon during the year are as follows:

| | **Share-based payments £m** | **Timing differences on capitalised costs £m** | **Tax losses £m** | **Other timing differences £m** | **Total £m** |
|---|---|---|---|---|---|
| **At 1 April 2015** | 6 | 54 | 69 | 1 | 130 |
| (Charge)/credit to the income statement | – | (1) | (13) | 2 | (12) |
| Charge to reserves | (3) | – | – | – | (3) |
| **At 31 March 2016** | 3 | 53 | 56 | 3 | 115 |

| | Share-based payments £m | Timing differences on capitalised costs £m | Tax losses £m | Timing differences on acquisition intangibles £m | Other timing differences £m | Total £m |
|---|---|---|---|---|---|---|
| **At 1 April 2014** | 7 | 61 | 39 | (1) | 1 | 107 |
| Credit/(charge) to the income statement | 2 | (7) | 30 | 1 | – | 26 |
| Charge to reserves | (3) | – | – | – | – | (3) |
| **At 31 March 2015** | 6 | 54 | 69 | – | 1 | 130 |

## 7. Taxation continued

**Tax – balance sheet** continued

No deferred tax assets and liabilities have been offset in either year, except where there is a legal right to do so in the relevant jurisdictions.

On 26 October 2015, a reduction in the UK statutory rate of taxation was substantively enacted, bringing the tax rate down from 20% to 19% with effect from 1 April 2017 and from 19% to 18% from 1 April 2020. Accordingly, the tax assets and liabilities recognised at 31 March 2016 take account of these changes. This has resulted in a tax charge of £9m to the income statement as the value of the Group's tax assets has been reduced, of which £3m relates to the prior year exceptional items (note 9).

During the prior year, the Company reviewed the period over which it recognises assets in respect of brought forward tax losses and revised this from five years to ten years due to the increased stability of the TV proposition. The incremental movement of £29m was recognised through exceptional items.

At 31 March 2016, the Group had unused tax losses of £650m (2015: £674m) available for offset against future taxable profits. A deferred tax asset of £56m (2015: £69m) has been recognised in respect of £299m (2015: £347m) of such losses, based on expectations of recovery in the foreseeable future.

No deferred tax asset has been recognised in respect of the remaining £351m (2015: £327m) as there is insufficient evidence that there will be suitable taxable profits against which these losses can be recovered. All losses may be carried forward indefinitely.

## 8. Dividends

**Accounting policy**

Dividend income is recognised when payment has been received. Final dividend distributions are recognised as a liability in the financial statements in the year in which they are approved by the relevant shareholders. Interim dividends are recognised in the year in which they are paid.

The following dividends were paid by the Group to its shareholders:

| | **2016 £m** | 2015 £m |
|---|---|---|
| **Ordinary dividends** | | |
| Final dividend for the year ended 31 March 2014 of 8.00p per ordinary share | – | 74 |
| Interim dividend for the year ended 31 March 2015 of 4.60p per ordinary share | – | 42 |
| Final dividend for the year ended 31 March 2015 of 9.20p per ordinary share | 85 | – |
| Interim dividend for the year ended 31 March 2016 of 5.29p per ordinary share | 50 | – |
| **Total ordinary dividends**[(1)] | 135 | 116 |

(1) Deducted from Company reserves. See Company statement of changes in equity on page 105.

The proposed final dividend for the year ended 31 March 2016 of 10.58p (2015: 9.20p) per ordinary share on approximately 946 million (2015: 922 million) ordinary shares (approximately £100m) was approved by the Board on 12 May 2016 and will be recommended to shareholders at the AGM on 20 July 2016. The dividend has not been included as a liability as at 31 March 2016.

The Group ESOT has waived its rights to receive dividends in the current and prior year and this is reflected in the analysis above.

# Notes to the consolidated financial statements continued

## 9. Reconciliation of Headline information to statutory information

Headline information is provided because the Directors consider that it provides assistance in understanding the Group's underlying performance.

### Accounting policy

Headline results are stated before the amortisation of acquisition intangibles and exceptional items. Exceptional items are those that are considered to be one-off or non-recurring in nature and so material that the Directors believe that they require separate disclosure to avoid distortion of the presentation of underlying performance and should be separately presented on the face of the income statement.

### Critical judgements in applying the Group's accounting policy

The classification of items as exceptional is subjective in nature and therefore judgement is required to determine whether the item is in line with the accounting policy criteria outlined above. Determining whether an item is exceptional is a matter of qualitative assessment, making it distinct from the Group's other critical accounting judgements where the basis for judgement is estimation.

| Year ended 31 March 2016 | EBITDA £m | Operating profit £m | Profit before taxation £m | Taxation £m | Profit for the year £m |
|---|---|---|---|---|---|
| **Headline results** | 260 | 131 | 107 | (28) | 79 |
| Exceptional items – Revenue – cyber attack (a) | (3) | (3) | (3) | 1 | (2) |
| Exceptional items – Operating expenses – cyber attack (b) | (39) | (39) | (39) | 8 | (31) |
| Exceptional items – Operating efficiencies (c) | (41) | (41) | (41) | 8 | (33) |
| Exceptional items – Acquisitions and disposal (d) | – | – | – | – | – |
| Exceptional items – Taxation (e) | – | – | – | (3) | (3) |
| Amortisation of acquisition intangibles (f) | – | (10) | (10) | 2 | (8) |
| **Statutory results** | 177 | 38 | 14 | (12) | 2 |

| Year ended 31 March 2015 | EBITDA £m | Operating profit £m | Profit before taxation £m | Taxation £m | Profit for the year £m |
|---|---|---|---|---|---|
| **Headline results** | 245 | 117 | 95 | (19) | 76 |
| Exceptional items – Revenue – other (a) | – | – | – | – | – |
| Exceptional items – Operating efficiencies (c) | (29) | (29) | (29) | 7 | (22) |
| Exceptional items – Acquisitions and disposal (d) | (9) | (9) | (9) | 2 | (7) |
| Exceptional items – Mobile migration | (8) | (8) | (8) | 2 | (6) |
| Exceptional items – Impairment loss[1] | – | (11) | (11) | 2 | (6) |
| Amortisation of acquisition intangibles (f) | – | (6) | (6) | 1 | (5) |
| Exceptional items – Taxation (e) | – | – | – | 45 | 45 |
| **Statutory results** | 199 | 54 | 32 | 40 | 72 |

(1) Includes £6m of non-operating amortisation.

### a) Revenue

#### Cyber attack

On 21 October 2015, there was a significant and sustained cyber attack on the TalkTalk website. Following this attack the Group has issued an increased number of credits to retain its customers. The costs of these credits are recognised against revenue and amount to £3m (2015: n/a).

A total taxation credit of £1m has been recognised on these costs in the year ended 31 March 2016 (2015: n/a).

#### Other

In the prior year statutory results were two items relating to ongoing commercial discussions; the treatment of prompt payment discounts and historical termination charge settlements with other Mobile Network Operators. The net impact of these two items was not material.

### b) Cyber attack

The Group has incurred costs in the year ended 31 March 2016 of £39m (2015: n/a). These costs include restoring our online capability with enhanced security features, associated IT, incident response and consultancy costs and providing free upgrades to our customers.

A total taxation credit of £8m (2015: n/a) has been recognised in relation to these items in the year ended 31 March 2016.

## 9. Reconciliation of Headline information to statutory information continued

**Critical judgements in applying the Group's accounting policy** continued

### c) Operating efficiencies – Making TalkTalk Simpler (MTTS)

During the year ended 31 March 2016, the Group continued its wide ranging transformation programme that is delivering material improvements to our customers' experience, driving operating cost savings, and reducing SAC through lower churn and costs per add (CPA).

The costs incurred in the year include work on improving Consumer and TalkTalk Business systems and processes which focus on customer experience; the review of the organisational structure of the business and the sites where the Group operates.

These programmes have resulted in £41m (2015: £29m) of costs including project management, redundancy, property, consultancy, migration and call centre costs.

A total taxation credit of £8m has been recognised on these costs in the year ended 31 March 2016 (2015: £7m).

### d) Acquisitions and disposal

In the prior year, the Group acquired broadband and voice customer bases from both Virgin Media Limited ('Virgin Media') and Tesco Stores Limited ('Tesco'). The Group has recognised an exceptional credit of £2m in the year ended 31 March 2016 in relation to the acquisition of Virgin Media, following the reassessment of the value of contingent consideration recognised for this acquisition.

During the year ended 31 March 2015, exceptional charges of £4m were recognised in relation to the migration of Virgin Media and Tesco customers onto the Group's network and integration costs including redundancy. Further to this, the Group also provided for £10m of costs in respect of committed future programmes predominantly in respect of migration, reorganisation and related costs.

A total taxation charge of £nil (2015: £2m) has been recognised in relation to these items in the year ended 31 March 2016.

Also in the prior year, the Group disposed of its Off-net broadband customer base to Fleur Telecom Limited. Following a delay in the migration of these customers, the Group has recognised an exceptional charge of £2m (2015: exceptional credit of £5m).

### e) Taxation items

The Group has recognised a tax charge of £3m which relates to the impact of the statutory corporation tax rate change from 20% to 19% and then to 18% on prior year exceptional tax assets. In the prior year, the time period over which VNL losses were recognised was increased from five to ten years which resulted in the recognition of an additional tranche of losses. This movement was treated as an exceptional item and, as such, the reduction in the tax rate relating to these losses has also been treated as exceptional in 2016.

### f) Amortisation of acquisition intangibles

An amortisation charge in respect of acquisition intangibles of £10m was incurred in the year ended 31 March 2016 (2015: £6m).

A total taxation credit of £2m has been recognised in the year ended 31 March 2016 (2015: £1m).

## 10. Earnings per ordinary share

Earnings per ordinary share are shown on a Headline and statutory basis to assist in the understanding of the performance of the Group.

| | **2016 £m** | 2015 £m |
|---|---|---|
| **Headline earnings (note 9)** | 79 | 76 |
| **Statutory earnings** | 2 | 72 |
| **Weighted average number of shares (millions):** | | |
| Shares in issue | 955 | 955 |
| Less weighted average holdings by Group ESOT | (19) | (33) |
| **For basic EPS** | 936 | 922 |
| Dilutive effect of share options (note 5) | 11 | 15 |
| **For diluted EPS** | 947 | 937 |

## 10. Earnings per ordinary share continued

| | 2016 Pence | 2015 Pence |
|---|---|---|
| **Basic earnings per ordinary share** | | |
| Headline | 8.4 | 8.2 |
| Statutory | 0.2 | 7.8 |

| | 2016 Pence | 2015 Pence |
|---|---|---|
| **Diluted earnings per ordinary share** | | |
| Headline | 8.3 | 8.1 |
| Statutory | 0.2 | 7.7 |

There are no share options considered anti-dilutive in the year ended 31 March 2016 (2015: nil).

## 11. Goodwill and other intangible assets

### (a) Goodwill

#### Accounting policy

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired is recognised initially as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

On disposal of a subsidiary undertaking, the relevant goodwill is included in the calculation of the profit or loss on disposal.

#### Critical judgements in applying the Group's accounting policy

The Group has two cash generating units (CGU) – TalkTalk Consumer and TalkTalk Business. For the purpose of impairment testing, at the acquisition date, goodwill is allocated to each of the CGUs expected to benefit from the synergies of the acquisition. The Group's shared costs and assets relating mainly to infrastructure and central overheads are allocated across the two CGUs based on the relative future cash flows that those shared costs support.

Determining whether goodwill is impaired requires estimation of the value in use of the CGUs to which the goodwill has been allocated. The value in use calculation involves estimation of both the future cash flows of the CGUs and the selection of appropriate discount rates to use to calculate present values.

#### Impairment of goodwill

Goodwill is not subject to amortisation but is tested for impairment annually or whenever there is an indication that the asset may be impaired; this review is performed at a CGU level.

Impairment is determined by assessing the future cash flows of the CGU to which the goodwill relates. The future cash flows of the Group are taken from the Board approved five year plan and extrapolated out to 20 years based on the UK's long term growth rate. This is discounted by the CGU's weighted average cost of capital pre-tax to give the net present value of that CGU. Where the net present value of future cash flows is less than the carrying value of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to the other assets of the CGU pro-rata on the basis of the carrying amount of each asset in the unit. Any impairment loss is recognised in the income statement and is not subsequently reversed.

Sensitivity analysis is performed using reasonably possible changes in the key assumptions.

| | 2016 £m | 2015 £m |
|---|---|---|
| Opening cost and net book value | 490 | 479 |
| Acquisitions (note 13) | 5 | 11 |
| **Closing cost and net book value** | 495 | 490 |

The goodwill acquired in business combinations is allocated at acquisition to the CGUs that are expected to benefit from that business combination. The allocation of goodwill across the CGUs is as follows:

| | 2016 £m | 2015 £m |
|---|---|---|
| TalkTalk Consumer | 347 | 348 |
| TalkTalk Business | 148 | 142 |
| | 495 | 490 |

### 11. Goodwill and other intangible assets continued

**(a) Goodwill** continued

#### Impairment review

The key assumptions used in the Group's goodwill impairment review are as follows:

- Long term growth rates
  Long term revenue growth rates applied are based on the growth rate for the UK per the Organisation for Economic Co-operation and Development (OECD). The rate applied in the current year was 2.0% (2015: 2.2%).
- Discount rate
  The underlying discount rate for each CGU is based on the UK ten year gilt rate adjusted for an equity risk premium and the systematic risk of the CGU. The average pre-tax rate for both CGUs used to discount the forecast cash flows is 10.2% (2015: 9.0%). The assumptions used in the calculation of the CGUs' discount rate are benchmarked to externally available data. The same discount rate has been applied to both CGUs due to the similarity of risk factors and geographical location.
- Capital expenditure
  Forecast capital expenditure is based on senior management expectations of future required support of the network and current run rate of expenditure, typically at 6% of revenue.
- Customer factors
  The key assumptions for the forecast cash flows of each of the CGUs are based on expected customer growth rates, ARPU, direct costs including acquisition costs, and changes in product mix. The value assigned to each of these assumptions has been determined based on the extrapolation of historical trends in the Group, adjusted for the impact of the cyber attack in the year and external information on expected trends of future market developments.

Sensitivity analysis has been performed for each key assumption and the Directors have not identified any reasonably possible changes in the key assumptions that would cause the carrying value of goodwill to exceed the recoverable amount.

**(b) Other intangible assets**

#### Accounting policy

##### Operating intangibles

Operating intangibles include internal infrastructure and design costs incurred in the development of software for internal use. Internally generated software is recognised as an intangible asset only if it can be separately identified, it is probable that the asset will generate future economic benefits, and the development cost can be measured reliably. Where these conditions are not met, development expenditure is recognised as an expense in the year in which it is incurred. Directly attributable costs that are capitalised include employee costs specifically incurred in the development of the intangible asset. Operating intangibles are amortised on a straight line basis over their estimated useful economic lives of up to eight years.

##### Acquisition intangibles

Acquired intangible assets such as customer bases and other intangible assets acquired through a business combination are capitalised separately from goodwill and amortised over their expected useful lives of up to six years on a straight line basis. The value attributed to such assets is based on the future economic benefit that is expected to be derived from them, calculated as the present value of future cash flows after a deduction for contributory assets.

#### Critical judgements in applying the Group's accounting policy

##### Impairment

At the acquisition date, acquisition intangibles are allocated to each of the CGUs expected to benefit from the synergies of the combination. The Group's shared costs and assets relating mainly to infrastructure and central overheads are allocated across the two CGUs based on the relative future cash flows.

Determining whether the carrying amounts of operating and acquisition intangibles have any indication of impairment requires judgement. If an indication of impairment is identified, further judgement is required to assess whether the carrying amounts can be supported by the value in use of the CGU that the asset is allocated to.

The value in use calculation involves estimation of both the future cash flows of the CGUs and the selection of appropriate discount rates to use to calculate present values.

##### Useful economic lives

The assessment of the useful economic lives of these operating and acquisition intangibles requires judgement. Amortisation is charged to the income statement based on the useful economic life selected. This assessment requires estimation of the period over which the Group will benefit from the assets.

### 11. Goodwill and other intangible assets continued

**(b) Other intangible assets** continued

Impairment of assets

The Group reviews the carrying amounts of its intangible assets to determine whether there is any indication that those assets have suffered an impairment loss at each reporting date. Where an indicator of impairment exists, the Group makes a formal estimate of the asset's recoverable amount and the extent of any impairment loss.

The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. In assessing value in use, the estimated cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset is estimated to be less than the carrying amount, the carrying amount of the asset or CGU is reduced to its recoverable amount.

Other intangible assets are analysed as follows:

| | Operating intangibles £m | Acquisition intangibles £m | Total other intangibles £m |
|---|---|---|---|
| **Opening balance at 1 April 2015** | 136 | 42 | 178 |
| Additions | 106 | – | 106 |
| Finalisation of provisional acquisition intangible (note 13) | – | 2 | 2 |
| Amortisation | (49) | (10) | (59) |
| **Closing balance at 31 March 2016** | 193 | 34 | 227 |
| Cost (gross carrying amount) | 458 | 142 | 600 |
| Accumulated amortisation | (265) | (108) | (373) |
| **Closing balance at 31 March 2016** | 193 | 34 | 227 |

| | Operating intangibles £m | Acquisition intangibles £m | Total other intangibles £m |
|---|---|---|---|
| **Opening balance at 1 April 2014** | 135 | 6 | 141 |
| Additions | 49 | – | 49 |
| Acquisition of subsidiary business combination | – | 42 | 42 |
| Amortisation | (42) | (6) | (48) |
| Exceptional items – Impairment loss | (6) | – | (6) |
| **Closing balance at 31 March 2015** | 136 | 42 | 178 |
| Cost (gross carrying amount) | 352 | 140 | 492 |
| Accumulated amortisation | (216) | (98) | (314) |
| **Closing balance at 31 March 2015** | 136 | 42 | 178 |

Operating intangibles

Operating intangibles includes internally generated assets with a net book value of £88m (2015: £59m), which are amortised over a period of up to eight years. This includes additions of £43m (2015: £31m) and an amortisation charge of £14m (2015: £10m) in the year ended 31 March 2016.

Included within operating intangibles is the following asset, which is material to the Group:

- TRIO, the customer billing system, which has a net book value of £47m (2015: £66m). TRIO is amortised over a period of up to eight years depending on the release date of the relevant component. The weighted average remaining useful economic life of the components of TRIO is two years (2015: three years).

Acquisition intangibles

Acquisition intangibles relate largely to the broadband customer bases acquired from Virgin Media and Tesco in the prior year; these customer bases are valued from the discounted future cash flows expected from them, after a deduction for contributory assets. The remainder of acquisition intangibles relates to the website acquired as part of the blinkbox transaction also in the prior year.

At 31 March 2016, the net book value of the acquired broadband bases are material to the Group; with the Virgin Media base valued at £16m (2015: £22m) and the Tesco base valued at £15m (2015: £16m), with remaining useful economic lives of 46 months (2015: 58 months) and 47 months (2015: 59 months) respectively.

## 12. Property, plant and equipment

### Accounting policy

Property, plant and equipment are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all property, plant and equipment at rates calculated to write off the cost, less estimated residual value, of each asset on a straight line basis over its expected useful life from the date it is brought into use, as follows:

| | |
|---|---|
| Short leasehold improvements | 10% or the lease term if less than ten years |
| Land and buildings | 3.33% per annum |
| Network equipment and computer hardware | 12.5–50% per annum |
| Fixtures and fittings | 20–25% per annum |

### Impairment of assets

#### Property, plant and equipment

The Group reviews the carrying amounts of its fixed assets to determine whether there is any indication that those assets have suffered an impairment loss at each reporting date. The Group uses the same methodology as set out in note 11 for operating and acquisition intangibles.

| | Leasehold improvements £m | Land and buildings £m | Network equipment and computer hardware £m | Fixtures and fittings £m | Total £m |
|---|---|---|---|---|---|
| **Opening balance at 1 April 2015** | – | – | 288 | 2 | 290 |
| Additions | – | 7 | 89 | – | 96 |
| Depreciation | – | – | (71) | (1) | (72) |
| Disposals | – | – | (12) | – | (12) |
| **Closing balance at 31 March 2016** | – | 7 | 294 | 1 | 302 |
| Cost (gross carrying amount) | 6 | 7 | 814 | 2 | 829 |
| Accumulated depreciation and impairment charges | (6) | – | (520) | (1) | (527) |
| **Closing balance at 31 March 2016** | – | 7 | 294 | 1 | 302 |

| | Leasehold improvements £m | Network equipment and computer hardware £m | Fixtures and fittings £m | Total £m |
|---|---|---|---|---|
| **Opening balance at 1 April 2014** | 5 | 300 | – | 305 |
| Additions | – | 67 | – | 67 |
| Acquisition of subsidiary | – | – | 2 | 2 |
| Depreciation | (5) | (73) | – | (78) |
| Impairment loss | – | (5) | – | (5) |
| Disposals | – | (1) | – | (1) |
| **Closing balance at 31 March 2015** | – | 288 | 2 | 290 |
| Cost (gross carrying amount) | 6 | 737 | 2 | 745 |
| Accumulated depreciation and impairment charges | (6) | (449) | – | (455) |
| **Closing balance at 31 March 2015** | – | 288 | 2 | 290 |

# Notes to the consolidated financial statements continued

## 13. Non-current asset investments

**Accounting policy**

Investments, other than subsidiaries, are initially recognised at cost, being the fair value of the consideration given plus any transaction costs associated with the acquisition.

Investments are categorised as available for sale and are recorded at fair value. Changes in fair value, together with any related taxation, are taken directly to equity and recycled to the income statement when the investment is sold or determined to be impaired.

Non-current asset investments at 31 March 2016 related to a 7.3% (2015: 7.3%) interest in Shared Band Limited, a telecommunications technology provider. The cost of the investment is not material.

### (a) Investments

The Parent Company has investments in the following subsidiary undertakings, which affected the profits or losses or net assets of the Group.

| Subsidiary undertakings | Country of incorporation or registration | Principal activity | Percentage of shareholding |
|---|---|---|---|
| TalkTalk Telecom Holdings Limited(1) | England & Wales | Holding company | 100 |
| Beheer-en Beleggingsmaatschappij Antika BV | Netherlands | Non-trading | 100 |
| Wireless Internet Portfolio BV | Netherlands | Non-trading | 100 |
| TalkTalk Brands Limited | England & Wales | Telecommunications | 100 |
| TalkTalk Group Ltd | England & Wales | Holding company | 100 |
| CPW Broadband Services (UK) Ltd | England & Wales | Telecommunications | 100 |
| Future Office Communications Limited | England & Wales | Telecommunications | 100 |
| TalkTalk Broadband Services (Ireland) Limited | Ireland | Non-trading | 100 |
| TalkTalk Business (2CCH) Limited | England & Wales | Telecommunications | 100 |
| TalkTalk Communications Limited | England & Wales | Telecommunications | 100 |
| CPW Network Services Limited | England & Wales | Telecommunications | 100 |
| TalkTalk Corporate Limited | England & Wales | Holding company | 100 |
| Core Telecommunications Limited | England & Wales | Non-trading | 100 |
| CPW UK Group Limited | England & Wales | Dormant | 100 |
| TalkTalk RB Limited (formerly Ratebuster Ltd) | England & Wales | Dormant | 100 |
| TalkTalk Technology Limited | England & Wales | Dormant | 100 |
| Telequip Limited | England & Wales | In liquidation | 100 |
| Telco Global Limited | England & Wales | Dormant | 100 |
| Vartec Telecom Europe Limited | England & Wales | Dormant | 100 |
| Video Networks Limited | England & Wales | Dormant | 100 |
| Wavetech Limited | England & Wales | In liquidation | 100 |
| World Online Telecom Limited | England & Wales | Dormant | 100 |
| GIS Telecoms Limited | England & Wales | Dormant | 100 |
| TalkTalk Direct Limited | England & Wales | Dormant | 100 |
| Opal Connect Limited | England & Wales | Dormant | 100 |
| Opal Business Solutions Limited | England & Wales | Dormant | 100 |
| UK Telco (GB) Limited | England & Wales | Dormant | 100 |
| TalkTalk UK Communications Services Limited | England & Wales | Dormant | 100 |
| Onetel Telecommunications Limited | England & Wales | Dormant | 100 |
| V Networks Limited | England & Wales | Dormant | 100 |
| Green Dot Property Management Limited | England & Wales | Non-trading | 100 |
| Executel Ltd | England & Wales | Dormant | 100 |
| Greystone Telecom Limited | England & Wales | Dormant | 100 |
| Pipex Internet Limited | England & Wales | Dormant | 100 |
| Pipex Communications Services Limited | England & Wales | Dormant | 100 |
| Pipex UK Limited | England & Wales | Dormant | 100 |
| TalkTalk Telecom Limited | England & Wales | Telecommunications | 100 |
| Telco Holdings Limited | England & Wales | Telecommunications | 100 |
| Telco Global Distribution Limited | England & Wales | Dormant | 100 |
| Tele2 Telecommunication Services Limited | Ireland | Non-trading | 100 |
| Tiscali UK Limited | England & Wales | Telecommunications | 100 |
| Toucan Residential Ireland Limited | Ireland | Non-trading | 100 |
| TalkTalk TV Entertainment Limited (formerly blinkbox) | England & Wales | Telecommunications | 100 |
| tIPicall Limited | England & Wales | Telecommunications | 100 |

(1) Directly held subsidiary.

## 13. Non-current asset investments continued

### Accounting policy continued

#### (a) Investments continued

| Joint venture undertakings | Country of incorporation or registration | Principal activity | Percentage of shareholding |
|---|---|---|---|
| YouView TV Limited | England & Wales | Telecommunications | 14.3 |
| Bolt Pro Tem Limited | England & Wales | Telecommunications | 33.3 |
| Internet Matters Limited | England & Wales | Telecommunications | 25.0 |

#### (b) Acquisitions and disposals

##### (i) Acquisitions

Movements in goodwill on acquisitions are analysed as follows:

| | **2016 £m** | 2015 £m |
|---|---|---|
| **Acquisitions during the year ended 31 March 2016:** | | |
| tIPicall Limited: | | |
| Provisional goodwill | 6 | – |
| | 6 | – |
| **Acquisitions during the year ended 31 March 2015:** | | |
| Virgin Media – broadband and voice customer base | – | 3 |
| Tesco – broadband and voice customer base | (1) | 3 |
| TalkTalk TV Entertainment Limited (formerly blinkbox) | – | 5 |
| | 5 | 11 |

The Group has made the following acquisition during the year ended 31 March 2016:

**tIPicall Limited**

On 22 April 2015, the Group acquired 100% shares of tIPicall Limited, a company providing Voice over Internet Protocol (VoIP) services. The acquisition was satisfied by £5m cash plus £1m of contingent consideration depending on the performance of the business.

The amounts recognised in respect of assets and liabilities acquired are immaterial to the Group. The book value of the assets acquired is expected to equal their fair value. On this basis provisional goodwill recognised in relation to the acquisition is £6m. This represents the future opportunities arising from the nature of the business and fit with the Group's existing operations. The provisional goodwill has been allocated to the Business cash generating unit (CGU).

The total impact on the Group for the year ended 31 March 2016 in relation to revenue and profit before taxation amounted to £2m and £nil respectively.

The Group made the following acquisitions during the year ended 31 March 2015:

**Virgin Media broadband customer base acquisition**

On 27 October 2014, the Group acquired the Virgin Media broadband service business from Virgin Media, which comprises broadband customers (MPF, SMPF and IP Stream). The acquisition is complementary to the Group's existing business model. The legal title of asset was transferred as the customers migrated to the Group's network, which substantially took place in the period from December 2014 to March 2015. As this is an acquisition of customer base, nil voting shares were acquired. Provisional goodwill of £3m was recognised, the goodwill represents the future economic benefit arising from the aligning of customers' existing products with the Group's products and its fit with existing operations. Goodwill has been allocated to the Consumer CGU.

In 2016, the fair value of the contingent consideration payable in relation to the Virgin Media customer base acquisition in the prior year was reassessed. A reduction in contingent consideration payable of £2m was required due to post-acquisition events and circumstances and therefore recognised as exceptional income (note 9).

# Notes to the consolidated financial statements continued

### 13. Non-current asset investments continued

**Accounting policy** continued

(b) Acquisitions and disposals continued

(i) Acquisitions continued

Tesco broadband and voice customer base acquisition

On 7 January 2015, the Group acquired the Tesco broadband service business from Tesco which comprises broadband (MPF, SMPF and IP Stream) and voice customers. The acquisition is complementary to the Group's existing business model. The legal title of asset was transferred on 1 March 2015. As this is an acquisition of customer base, nil voting shares were acquired. Provisional goodwill of £3m was recognised, the goodwill represents the future economic benefit arising from aligning the customers' existing products with the Group's products and its fit with existing operations. Goodwill has been allocated to the Consumer CGU.

In 2016, the fair value of the contingent consideration payable in relation to the Tesco customer base acquisition in the prior year was reassessed. A reduction in contingent consideration payable of £3m was required due to pre-acquisition events and circumstances. An increase in the acquisition intangible of £2m and an increase in the provision for unfavourable contracts of £4m was also required due to pre-acquisition events and circumstances. All these movements were taken to goodwill in line with IFRS 3.

TalkTalk TV Entertainment Limited (formerly blinkbox) acquisition

On 7 January 2015, the Group acquired 100% of the issued and voting share capital of TalkTalk TV Entertainment Limited (formerly blinkbox) from Tesco Holdings Limited. The acquisition is complementary to the Group's existing business model. TalkTalk TV Entertainment Limited (formerly blinkbox) provides movies and TV series online for customers to stream or download on demand.

Summary of final financial impacts of prior year acquisitions

The net assets recognised in the prior year were based on a provisional assessment of their fair values. During 2016, the fair values have been reassessed and no adjustments have been identified for the acquisition of Virgin Media and TalkTalk TV Entertainment Limited (formerly blinkbox). The reassessment of the provisional fair values in relation to the acquisition of Tesco is summarised below:

| Tesco broadband and voice customer base | Provisional fair values £m | Reassessed fair values £m | Hindsight adjustment £m |
|---|---|---|---|
| **Consideration** | **18** | **15** | **(3)** |
| Total consideration – cash | 14 | 8 | (6) |
| Total consideration – deferred | 4 | 7 | 3 |
| **Net assets acquired** | **15** | **13** | **(2)** |
| Customer base | 17 | 19 | 2 |
| Provision for unfavourable contract | (2) | (6) | (4) |
| **Goodwill** | **3** | **2** | **(1)** |

(ii) Disposals

In the prior year, the Group agreed to dispose of its existing Off-net broadband customer base to Fleur Telecom Limited (Fleur), a member of Daisy Communications Group, for a contingent consideration of £8m, generating a profit on disposal of £5m. The expected cost to sell of £3m was included within the Group's trade and other payables. The consideration is contingent on the performance of this customer base in the period of 24 months following the network migration completion date.

In the current year, due to a delay in the migration of customers to Fleur, the contingent consideration receivable and expected costs to sell were reassessed. This resulted in a net exceptional charge of £2m (note 9). As at 31 March 2016, there is contingent consideration receivable of £1m included within current assets. There are no further expected costs to sell as at 31 March 2016.

The customer base was derecognised from the balance sheet at the completion date of 31 March 2015.

(iii) Asset held for sale

In the prior year, the Group agreed to sell the acquired Off-net broadband base from Virgin Media and Tesco to Fleur.

During the year, the Group finalised the disposal of the Off-net broadband base that it had acquired from Virgin Media to Fleur. The asset held for sale was held at fair value giving rise to no profit/(loss) on disposal. In addition, the asset held for sale for the acquired Off-net broadband base from Virgin Media is not material.

## 14. Interest in joint ventures

**Accounting policy**

Interests in joint ventures are accounted for using the equity method. The Group income statement includes the Group's share of the post-tax profits or losses of the joint ventures based on their financial statements for the year.

In the Group balance sheet, the Group's interest in joint ventures is shown as a non-current asset, representing the Group's investment in the share capital of the joint ventures, as adjusted for post-acquisition changes in the Group's share of the net assets or liabilities less provision for any impairment.

In addition to the carrying amount of the investment, the Group's interest in joint ventures includes, where applicable, any long term interests in the venture that, in substance, form part of the Group's net investment in the joint venture. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the Group's interest in that joint venture.

Any loans advanced to a joint venture that, in substance, do not form part of the Group's net investment are shown separately in the balance sheet as a receivable to the Group. Losses recognised using the equity method in excess of the Group's investment in ordinary shares are applied to the other components of the Group's interest in the joint venture in the reverse order of their seniority (i.e. priority in liquidation).

### YouView TV Limited ('YouView')

The Group holds 14.3% (2015: 14.3%) of the ordinary share capital of YouView, a joint venture with The British Broadcasting Corporation, ITV Broadcasting Limited, British Telecom PLC (BT), Channel Four Television Corporation, Arqiva Limited and Channel 5 Broadcasting Limited. The joint venture was set up in order to develop a free-to-air internet-connected TV service to UK homes. During the prior year, the Group signed a new agreement with the other existing holders of YouView whereby all seven original partners (together 'Tier 1' funders) continue to contribute approximately £1m per annum to fund basic operational and technology costs of YouView, and the Group together with BT as 'Tier 2' funders contribute up to a further £10m per annum for additional development of the technology to support their TV propositions. The Group's total contribution to YouView in the year ended 31 March 2016 was £8m (2015: £8m).

There was no change in the overall control of the joint venture as a result of these changes as all seven partners share overall control. Under this agreement, the Group's share of losses comprises one-seventh of any Tier 1 loss and half of any Tier 2 loss. During the year ended 31 March 2016, the Group recognised a £7m share of losses (2015: £8m).

The Group has reviewed the carrying value of YouView and has concluded that there is no indication of impairment.

### Bolt Pro Tem Limited

The Group holds 33.3% of the ordinary share capital of Bolt Pro Tem Limited (BPT), a joint venture with British Sky Broadcasting Limited (BSkyB) and City Fibre Holdings Limited. The joint venture was set up in the prior year to deliver fibre to the premise (FTTP) broadband services in the City of York. The Group has committed to contributing £5m over the three year period to 31 March 2017. During the year ended 31 March 2016, the Group contributed £1m (2015: £3m) to the joint venture and received £nil share of losses (2015: £nil).

During the year, due to an increased certainty around the time of the repayment of a portion of the Group's contribution to BPT, it was concluded that £3m was, in substance, a loan to BPT and not an extension of the investment in the joint venture. This has therefore been reclassified on the balance sheet as a non-current trade and other receivable.

The Group has reviewed the carrying value of BPT and has concluded that there is no indication of impairment.

# Notes to the consolidated financial statements continued

## 14. Interest in joint ventures continued

**Accounting policy** continued

### Internet Matters Limited

During the year ended 31 March 2014, the Group, alongside BSkyB, BT and Virgin Media established an equal membership joint venture, Internet Matters Limited. It is a not-for-profit company set up as an industry-led body to promote and educate parents about internet safety for children. The Group is committed to contributing £2m over the remaining two year period to 31 March 2017.

Interest in joint ventures are analysed as follows:

| | 2016 £m | 2015 £m |
|---|---|---|
| **Opening balance at 1 April** | 10 | 7 |
| Additions | 10 | 11 |
| Share of results | (8) | (8) |
| Reclassification to non-current assets – trade and other receivables | (3) | – |
| **Closing balance at 31 March** | 9 | 10 |

The Group's share of the results, assets and liabilities of its joint ventures are as follows:

| Group share of results of joint ventures | 2016 £m | 2015 £m |
|---|---|---|
| Expenses | (8) | (8) |
| Loss before taxation | (8) | (8) |
| Taxation | – | – |
| Loss after taxation | (8) | (8) |

| Group share of net assets of joint ventures | 2016 £m | 2015 £m |
|---|---|---|
| Non-current assets | 9 | 10 |
| Net assets | 9 | 10 |

## 15. Inventories

**Accounting policy**

Inventories are stated at the lower of cost and net realisable value, valued on a FIFO basis, and consists primarily of set top boxes, power line adaptors and routers. Net realisable value is based on estimated selling price, less costs expected to be incurred. A provision is made for obsolete items where appropriate.

| | 2016 £m | 2015 £m |
|---|---|---|
| Goods for resale | 57 | 31 |

## 16. Trade and other receivables

**Critical judgements in applying the Group's accounting policy**

Judgement is required in order to evaluate the likelihood of collection of customer debt after revenue has been recognised and hence the value of the bad and doubtful debt. These provisions are based on historical trends in the percentage of debts which are not recovered.

Trade and other receivables comprise:

| | **2016 £m** | 2015 £m |
|---|---|---|
| **Current – trade and other receivables** | | |
| Trade receivables – gross | 174 | 178 |
| Less provision for impairment | (30) | (25) |
| Trade receivables – net | 144 | 153 |
| Other receivables | 84 | 79 |
| Prepayments | 21 | 29 |
| Accrued income | 45 | 51 |
| Assets held for sale | – | 1 |
| **Trade and other receivables** | 294 | 313 |

The Directors estimate that the carrying amount of trade receivables approximates to their fair value.

The average credit period taken on trade receivables, calculated by reference to the amount owed at the year end as a proportion of total revenue in the year, was 29 days (2015: 30 days).

The Group's trade receivables are denominated in the following currencies:

| | **2016 £m** | 2015 £m |
|---|---|---|
| UK Sterling | 163 | 166 |
| Other | 11 | 12 |
| | 174 | 178 |

The ageing of gross trade receivables is as follows:

| | **2016 £m** | 2015 £m |
|---|---|---|
| Not yet due | 65 | 95 |
| 0 to 2 months | 28 | 20 |
| 2 to 4 months | 21 | 19 |
| Over 4 months | 60 | 44 |
| | 174 | 178 |

The ageing of the provision for impairment of trade receivables is as follows:

| | **2016 £m** | 2015 £m |
|---|---|---|
| Not yet due | (1) | (1) |
| 0 to 2 months | (1) | (1) |
| 2 to 4 months | – | – |
| Over 4 months | (28) | (23) |
| | (30) | (25) |

# Notes to the consolidated financial statements continued

## 16. Trade and other receivables continued

**Critical judgements in applying the Group's accounting policy** continued

Movements in the provisions for impairment of trade receivables are as follows:

| | 2016 £m | 2015 £m |
|---|---|---|
| Opening balance | (25) | (34) |
| Charged to the income statement | (71) | (62) |
| Receivables written off as irrecoverable | 66 | 71 |
| | (30) | (25) |

Trade receivables of £80m (2015: £59m) were past due, but not impaired. These balances primarily relate to TalkTalk Consumer and TalkTalk Business fixed line customers. The Group has made provisions based on historical rates of recoverability and all unprovided amounts are considered to be recoverable. The ageing analysis of these trade receivables is as follows:

| | 2016 £m | 2015 £m |
|---|---|---|
| 0 to 2 months | 27 | 19 |
| 2 to 4 months | 21 | 19 |
| Over 4 months | 32 | 21 |
| | 80 | 59 |

## 17. Trade and other payables

| | 2016 £m | 2015 £m |
|---|---|---|
| Trade payables | 304 | 218 |
| Other taxes and social security costs | 28 | 35 |
| Other payables | 19 | 22 |
| Accruals | 150 | 176 |
| Deferred income | 62 | 65 |
| | 563 | 516 |

The Group has commercially agreed longer credit terms with certain suppliers. Excluding these suppliers, the underlying average credit period taken on trade payables was 40 days (2015: 33 days). Including these suppliers, the average credit period taken was 56 days (2015: 43 days). Included in trade payables are capital payables amounting to £55m (2015: £33m).

Rebates receivable from suppliers are accounted for in accordance with the policy set out in note 1.

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

## 18. Cash and cash equivalents and borrowings

**(a) Cash and cash equivalents are as follows:**

| | 2016 £m | 2015 £m |
|---|---|---|
| Cash at bank and in hand | 10 | 10 |

The effective interest rate on bank deposits and money market funds was 0.3% (2015: 0.6%).

**(b) Borrowings comprise:**

| | Maturity | 2016 £m | 2015 £m |
|---|---|---|---|
| **Current** (£100m term loan) | 2017 | 25 | – |

| | Maturity | 2016 £m | 2015 £m |
|---|---|---|---|
| **Non-current** | | | |
| $185m US Private Placement (USPP) Notes | 2021, 2024, 2026 | 129 | 125 |
| £560m revolving credit facility | 2019 | 430 | 340 |
| £100m bilateral agreements | 2019 | 50 | 50 |
| £100m term loan (of which £25m is current) | 2018, 2019 | 75 | 100 |
| £100m revolving credit facility | 2017 | – | – |
| Non-current borrowings before derivatives | | 684 | 615 |
| Total borrowings before derivatives | | 709 | 615 |
| Derivatives | | (20) | (16) |
| Borrowings after derivatives | | 689 | 599 |

| | Maturity | 2016 £m | 2015 £m |
|---|---|---|---|
| Undrawn available committed facilities | 2017, 2019 | 255 | 220 |

The book value and fair value of the Group's borrowings, all of which are in Sterling, are as follows:

| | 2016 £m | 2015 £m |
|---|---|---|
| Less than 1 year | 25 | – |
| 1 to 2 years | 25 | 25 |
| 2 to 3 years | – | 25 |
| 3 to 4 years | 530 | – |
| 4 to 5 years | – | 440 |
| Greater than 5 years | 109 | 109 |
| Borrowings after derivatives | 689 | 599 |

## 18. Cash and cash equivalents and borrowings continued

**(b) Borrowings comprise** continued

### Borrowing facilities

The Group's committed facilities increased by £125m in the year to £944m (2015: £819m) as a result of signing two new facilities in the year.

The financial covenants included in all facilities are identical; they restrict the ratio of net debt to EBITDA and require minimum levels of interest cover.

The Group was in compliance with its covenants throughout the current and prior year.

Details of the borrowing facilities of the Group as at 31 March 2016 are set out below:

#### $185m USPP Notes

In July 2014 the Group issued $185m of USPP Notes maturing in three tranches ($139m in 2021, $25m in 2024 and $21m in 2026). The interest rate payable on the notes is at a margin over US treasury rate for the appropriate period. The USPP proceeds were swapped to Sterling to give £109m (£82m in 2021, £15m in 2024 and £12m in 2026) and the net debt includes retranslation of the USPP funds at the rates achieved where hedged by cross-currency interest swaps.

#### £560m revolving credit facility (RCF) and £100m bilateral agreements

The Group has a £560m RCF, which matures in July 2019. The interest rate payable in respect of drawings under this facility is at a margin over LIBOR and for the appropriate period. The actual margin applicable to any drawing depends on the ratio of net debt to Headline EBITDA calculated in respect of the most recent accounting period. In addition to the RCF, the Group also has two £50m bilateral agreements, signed in July 2014 and August 2015 and both mature in July 2019. Of the £50m bilateral agreement that was signed in August 2015, £25m has subsequently been cancelled. The terms of the bilateral agreements are consistent with the main RCF.

#### £100m term loan

The Group has a committed term loan of £100m (2015: £100m), with a final maturity date of July 2019. This loan amortises over the term with repayments due of £25m in January 2017, £25m in January 2018 and the remainder in July 2019. The interest rate payable in respect of drawings under this facility is at a margin over LIBOR for the relevant currency and for the appropriate period. The actual margin applicable to any drawing depends on the ratio of net debt to Headline EBITDA calculated in respect of the most recent accounting period.

#### £100m revolving credit facility (RCF)

In January 2016 the Group signed a £100m RCF which matures in May 2017. The interest rate payable in respect of drawings under this facility is at a margin over LIBOR and for the appropriate period. The actual margin applicable to any drawing depends on the ratio of net debt to EBITDA calculated in respect of the most recent accounting period.

### Bank overdrafts

Overdraft facilities are used to assist in short term cash management; these uncommitted facilities bear interest at a margin over the Bank of England base rate.

## 19. Financial risk management and derivative financial instruments

The book value and fair value of the Group's financial assets, liabilities and derivative financial instruments, excluding the Group's borrowings shown in note 18, are as follows:

| | **2016 £m** | 2015 £m |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | **10** | 10 |
| Trade and other receivables(1) | **294** | 313 |
| **Non-current assets** | | |
| Non-current investments and investment in joint venture | **9** | 10 |
| Trade and other receivables | **3** | – |
| Derivative financial instruments(2) | **18** | 11 |
| **Current liabilities** | | |
| Trade and other payables(3) | **(563)** | (516) |
| **Non-current liabilities** | | |
| Derivative financial instruments | **(1)** | (1) |
| | **(230)** | (173) |

(1) Accrued income has been included within the other receivables so as to give completeness over the Group's future cash inflows.

(2) Derivative financial instrument on the USPP Notes, consists of £20m (2015: £16m) foreign currency hedge and (£2m) (2015: (£5m)) in relation to interest rate hedge.

(3) Deferred income has been included within the financial liabilities so as to give completeness over the Group's contractual commitments on future cash outflows.

**19. Financial risk management and derivative financial instruments** continued

**(a) Financial instruments**

The Group's activities expose it to a variety of financial risks including market risk (such as currency risk and interest rate risk), credit risk and liquidity risk. The Group Treasury function uses certain financial instruments to mitigate potential adverse effects on the Group's financial performance from these risks. These financial instruments primarily consist of bank loans and interest rate swaps. Other products, such as currency options, can also be used depending on the risks to be covered, but have not been used in the current or preceding financial year. The Group does not trade or speculate in any financial instruments.

The Group has cash flow hedges in place to (a) swap the interest rate risk on the RCF from floating to fixed and (b) swap the currency and interest rate risk on the USPP debt from USD to GBP and from fixed US Treasury interest rates to fixed GBP interest rates. These hedges have been fully effective from inception. The fair value measurement is classified as Level 2 (2015: Level 2), derived from other observable market data; this means that their fair value is based upon the mark to market valuation at the balance sheet date. Fair value measurement at Level 2 gives consideration to interest rates, yield curves and foreign exchange rates at commonly quoted intervals for relevant currencies. The Group has also assessed the credit risk within its financial instruments. The fair value of these instruments at 31 March 2016 was £17m (2015: £10m). A gain of £2m (2015: loss of £5m) has been recognised in other comprehensive income in the year ended 31 March 2016. As the hedges were fully effective there has been no income statement impact.

**(b) Embedded derivatives**

No contracts with embedded derivatives have been identified and accordingly, no such derivatives have been accounted for separately.

**(c) Foreign exchange risk**

The Group uses spot and forward foreign exchange trading to hedge transactional exposures, which arise mainly through cost of sales and operating expenses, and are primarily denominated in Euro and US Dollar. The Group also uses cross-currency swaps to hedge its US Dollar denominated borrowings (US Private Placement). At 31 March 2016 the adjustment to translate our net debt to Sterling at swap rates to reflect the impact of hedging was £20m (2015: £16m).

Borrowings and foreign exchange contracts are sensitive to movements in foreign exchange rates; this sensitivity can be analysed in comparison to year-end rates. There was no material impact of a 10% movement in the UK Sterling/Euro exchange rate on either the income statement or other equity. The effect of foreign exchange derivatives on borrowings at the year end was as follows:

| | **UK Sterling £m** | **Euro £m** | **USD £m** | **Total £m** |
|---|---|---|---|---|
| **2016** | | | | |
| Borrowings before derivatives | 580 | – | 129 | 709 |
| Derivatives | – | – | (20) | (20) |
| Borrowings after derivatives | 580 | – | 109 | 689 |

| | UK Sterling £m | Euro £m | USD £m | Total £m |
|---|---|---|---|---|
| **2015** | | | | |
| Borrowings before derivatives | 490 | – | 125 | 615 |
| Derivatives | – | – | (16) | (16) |
| Borrowings after derivatives | 490 | – | 109 | 599 |

During the year, the Group used derivatives for the management of US Private Placement debt, foreign currency cash balances and foreign currency trading balances.

# Notes to the consolidated financial statements continued

## 19. Financial risk management and derivative financial instruments continued

### (d) Interest rate risk

The Group's interest rate risk arises primarily from cash, cash equivalents and borrowings, all of which are at floating rates of interest and thus expose the Group to cash flow interest rate risk. These floating rates are linked to LIBOR and other interest rate bases as appropriate to the instrument and currency. Future cash flows arising from these financial instruments depend on interest rates and periods for each loan or rollover. As detailed in section (a), the Group has cash flow hedges in place to mitigate its interest rate risk on its borrowings.

Cash and borrowings, as well as some foreign exchange products, are sensitive to movements in interest rates and such movements have been analysed in the table below by calculating the effect on the income statement and equity of a one percentage point movement in the interest rate for the currencies in which most Group cash and borrowings are denominated. Funding to related parties has been offset against gross borrowings in calculating these sensitivities. This annualised analysis has been prepared on the assumption that the year end positions prevail throughout the year, and therefore may not be representative of fluctuations in levels of borrowings.

| | **2016 £m** | 2015 £m |
|---|---|---|
| **100 basis points movement in the UK Sterling interest rate** | | |
| Income statement movement | 4 | 3 |

### (e) Liquidity risk

The Group manages its exposure to liquidity risk by regularly reviewing the long and short term cash flow projections for the business against facilities and other resources available to it. Headroom is assessed based on historical experience as well as by assessing current business risks, including foreign exchange movements. Existing bank debt facilities do not expire until May 2017 and July 2019, USPP debt matures in three tranches in July 2021, 2024 and 2026; it is Group policy to refinance debt maturities significantly ahead of maturity dates.

The table below analyses the Group's financial liabilities into relevant maturity groupings. The amounts disclosed in the table are the contractual undiscounted gross cash flows assuming year end interest rates remain constant and that borrowings are paid in full in the year of maturity.

| | **Less than 1 year £m** | **1 to 2 years £m** | **2 to 3 years £m** | **3 to 4 years £m** | **4 to 5 years £m** | **More than 5 years £m** | **Total £m** |
|---|---|---|---|---|---|---|---|
| **2016** | | | | | | | |
| Borrowings | (46) | (44) | (18) | (539) | (5) | (135) | (787) |
| Derivative financial instruments – receivable | – | – | – | – | – | 20 | 20 |
| Trade and other payables | (563) | – | – | – | – | – | (563) |
| | (609) | (44) | (18) | (539) | (5) | (115) | (1,330) |

| | Less than 1 year £m | 1 to 2 years £m | 2 to 3 years £m | 3 to 4 years £m | 4 to 5 years £m | More than 5 years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **2015[(1)]** | | | | | | | |
| Borrowings | (17) | (41) | (40) | (15) | (448) | (136) | (697) |
| Derivative financial instruments – receivable | – | – | – | – | – | 16 | 16 |
| Trade and other payables | (516) | – | – | – | – | – | (516) |
| | (533) | (41) | (40) | (15) | (448) | (120) | (1,197) |

(1) The 2015 comparatives have been re-presented to include interest cash flows.

### (f) Credit risk

The Group's exposure to credit risk is regularly monitored. Debt, investments, foreign exchange and derivative transactions are all spread amongst a number of banks, all of which have short or long term credit ratings appropriate to the Group's exposures. Trade receivables primarily comprise balances due from fixed line customers, and provision is made for any receivables that are considered to be irrecoverable.

## 19. Financial risk management and derivative financial instruments continued

### (g) Capital risk management

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders. The Group's objective is to maintain diversified sources of funding, including committed and uncommitted bank facilities, private and public bonds and working capital solutions.

The capital structure of the Group currently consists of debt, which includes the borrowings disclosed in note 18, cash and cash equivalents, operating leases and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in notes 21 to 22.

The Group's Board reviews the capital structure on an annual basis. As part of this review, the Board concluded that it is more appropriate to align its measures with the external metrics in the banking agreement. The Group uses the ratio of net debt to Headline EBITDA and has a medium term ratio target below 2.0x. The ratio at 31 March 2016 is 2.6x post the cyber attack. As the business returns to normal, the Board expects the ratio will return to its target in the medium term.

The net debt to Headline EBITDA ratio at the year end is as follows:

| | 2016<br>£m | 2015<br>£m |
|---|---|---|
| Debt | (709) | (615) |
| Cash and cash equivalents | 10 | 10 |
| Derivatives | 20 | 16 |
| Net debt | (679) | (589) |
| Headline EBITDA | 260 | 245 |
| Net debt to Headline EBITDA ratio | 2.6x | 2.4x |

## 20. Provisions

The tables below analyses the Group's provisions:

| | 2016<br>£m | 2015<br>£m |
|---|---|---|
| Current | 18 | 34 |
| Non-current | 11 | 1 |
| | 29 | 35 |

| | Operating efficiencies – MTTS<br>£m | One Company integration<br>£m | Property<br>£m | Contract and other<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| **2016** | | | | | |
| Opening balance | – | 1 | 2 | 32 | 35 |
| Charged to income statement | – | – | 11 | 17 | 28 |
| Released to income statement | – | – | (1) | – | (1) |
| Utilised in the year | – | – | – | (33) | (33) |
| | – | 1 | 12 | 16 | 29 |

| | Operating efficiencies – MTTS<br>£m | One Company integration<br>£m | Property<br>£m | Contract and other<br>£m | Total<br>£m |
|---|---|---|---|---|---|
| **2015** | | | | | |
| Opening balance | 1 | 1 | 7 | – | 9 |
| Charged to income statement | – | – | – | 32 | 32 |
| Released to income statement | – | – | (2) | – | (2) |
| Utilised in the year | (1) | – | (3) | – | (4) |
| Closing balance | – | 1 | 2 | 32 | 35 |

# Notes to the consolidated financial statements continued

## 20. Provisions continued

**Accounting policy**

Provisions are recognised when a legal or constructive obligation exists as a result of past events and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are discounted where the time value of money is considered to be material.

Provisions are categorised as follows:

### One Company integration

These provisions relate principally to reorganisation costs and are only recognised where plans are demonstrably committed and where appropriate communication to those affected has been undertaken at the balance sheet date. These provisions are expected to be utilised over the next twelve months.

### Property

Property provisions relate to dilapidations and similar property costs, and costs associated with onerous property contracts. All such provisions are assessed by reference to the terms and conditions of the contract and market conditions at the balance sheet date. Onerous property contracts are expected to be utilised over the next seven years. Dilapidation provisions are expected to be utilised as and when properties are exited. These provisions include the costs of exiting our Warrington and Irlam sites, as the Group relocates to one site at the Soapworks in Salford in April 2017.

### Contract and other

Contract and other provisions relate mainly to customer migration costs as a result of the customer base acquisitions in the current year and the SIM replacement costs as part of the mobile migration programme provided for in the prior year. The remaining are provisions on onerous contracts and contracts with unfavourable terms arising on the acquisition of businesses and anticipated costs of unresolved legal disputes. All such provisions are assessed by reference to the best available information at the balance sheet date.

## 21. Share capital

| | **2016 million** | 2015 million | **2016 £m** | 2015 £m |
|---|---|---|---|---|
| **Allotted, called up and fully paid** | | | | |
| Ordinary shares of 0.1p each | 955 | 955 | 1 | 1 |

## 22. Reserves

**Share premium**

The share premium account records the difference between the nominal amount of shares issued and the fair value of the consideration received. The share premium account may be used for certain purposes specified by UK law, including to write off expenses incurred on any issue of shares or debentures and to pay up fully paid bonus shares. The share premium account is not distributable but may be reduced by special resolution of the Company's ordinary shareholders and with court approval.

**Translation reserve**

The results of overseas operations are translated at the average foreign exchange rates for the year, and their balance sheets are translated at the rates prevailing at the balance sheet date. Exchange differences arising on the translation of opening net assets and results of overseas operations are recognised in the translation and hedging reserve. All other exchange differences are included in the income statement.

**Demerger reserve**

The demerger reserve primarily reflects the profits or losses arising on the transfer of investments and net assets of CPW on demerger.

**Other reserve – Group ESOT**

The Group ESOT held nine million shares at 31 March 2016 (2015: 33 million) in the Company for the benefit of employees. During the period, the Trustees of the Group ESOT reassessed their holdings in relation to the number of options expected to be exercised in the future. This resulted in the sale of 20 million shares, generating net proceeds of £61m. The Group ESOT has waived its rights to receive dividends and none of its shares have been allocated to specific schemes. At the year end the shares had a market value of £22m (2015: £112m).

## 23. Analysis of changes in net debt

| | Opening £m | Net cash flow £m | Non-cash movements £m | Closing £m |
|---|---|---|---|---|
| **2016** | | | | |
| Cash and cash equivalents | 10 | – | – | 10 |
| Borrowings | (615) | (90) | (4) | (709) |
| Derivatives | 16 | – | 4 | 20 |
| | (599) | (90) | – | (689) |
| **Total net debt** | (589) | (90) | – | (679) |

| | Opening £m | Net cash flow £m | Non-cash movements £m | Closing £m |
|---|---|---|---|---|
| **2015** | | | | |
| Cash and cash equivalents | – | 10 | – | 10 |
| Bank overdrafts | (7) | 7 | – | – |
| | (7) | 17 | – | 10 |
| Borrowings | (490) | (109) | (16) | (615) |
| Derivatives | – | – | 16 | 16 |
| | (490) | (109) | – | (599) |
| **Total net debt** | (497) | (92) | – | (589) |

## 24. Commitments under operating leases

The Group leases network infrastructure and offices under non-cancellable operating leases. The leases have varying terms, purchase options, escalation clauses and renewal rights. There were no leases which were individually significant to the Group.

The Group had outstanding commitments for future minimum payments due as follows:

| | **2016** | | | 2015 | | |
|---|---|---|---|---|---|---|
| | **Property** | **Network equipment** | **Total £m** | Property | Network equipment | Total £m |
| Less than 1 year | 11 | 33 | 44 | 10 | 27 | 37 |
| 2 to 5 years | 37 | 27 | 64 | 31 | 34 | 65 |
| Greater than 5 years | 55 | 12 | 67 | 40 | 18 | 58 |
| | 103 | 72 | 175 | 81 | 79 | 160 |

# Notes to the consolidated financial statements continued

### 25. Commitments

The Group has in the normal course of business entered into various multi-year supply and working capital agreements for core network, IT and customer equipment. As at the 31 March 2016, expenditure contracted, but not provided for in these financial statements amounted to £318m (2015: £450m). Of this amount, £55m (2015: £85m) related to capital commitments and £25m (2015: £nil) related to the supply of customer equipment.

### 26. Related party transactions

**a) Subsidiaries and joint ventures**

Details of subsidiaries and joint ventures are disclosed in notes 13 and 14 respectively.

**b) Directors**

The remuneration of the Directors, who are some of the key management personnel of the Group, is set out in the Directors' Remuneration Report on pages 37 to 55. The remuneration of all key management personnel is disclosed in note 4.

### 27. Contingent liabilities

As at 31 March 2014, the Group had received £33m in total in relation to an Ofcom determination that BT had overcharged for certain wholesale Ethernet services. During the year ended 31 March 2015, BT lost its appeal against Ofcom's determination in the Competition Appeal Tribunal and appealed to the Court of Appeal. This appeal is due to be heard in the Court of Appeal in March 2017. The Group considers the appeal is unlikely to succeed based on the advice received and so no liability for repayment has been recorded at the year end, although the outcome of the appeal is not yet certain.

# Company balance sheet

As at 31 March 2016

| | Notes | 2016 £m | 2015 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Investments in subsidiaries and joint ventures | 4 | 1,196 | 1,184 |
| Derivative financial instrument | | 18 | 11 |
| | | 1,214 | 1,195 |
| **Current assets** | | | |
| Cash and cash equivalents | | 634 | 594 |
| Corporation tax receivable | | 2 | 2 |
| Trade and other receivables | 5 | 15 | 82 |
| | | 651 | 678 |
| **Total assets** | | 1,865 | 1,873 |
| **Current liabilities** | | | |
| Trade and other payables | 6 | (55) | (37) |
| | | (55) | (37) |
| **Non-current liabilities** | | | |
| Borrowings | 7 | (709) | (615) |
| Derivative financial instrument | | (1) | (1) |
| | | (710) | (616) |
| **Total liabilities** | | (765) | (653) |
| **Net assets** | | 1,100 | 1,220 |
| **Equity** | | | |
| Share capital | 8, 9 | 1 | 1 |
| Share premium | 9 | 684 | 684 |
| Retained earnings and other reserves | 9 | 415 | 535 |
| **Total equity** | | 1,100 | 1,220 |

The accompanying notes are an integral part of this Company balance sheet.

These financial statements were approved by the Board on 12 May 2016. They were signed on its behalf by:

**D Harding**
**Chief Executive Officer**

**I Torrens**
**Chief Financial Officer**

# Company cash flow statement

For the year ended 31 March 2016

| | Notes | 2016 £m | 2015 £m |
|---|---|---|---|
| **Operating activities** | | | |
| Operating loss | | (3) | (3) |
| Share-based payments | | 5 | 4 |
| **Operating cash flows before movements in working capital** | | 2 | 1 |
| Decrease in trade and other receivables | | 49 | 58 |
| Increase/(decrease) in trade and other payables | | 56 | (23) |
| **Cash generated from operations** | | 107 | 36 |
| Income taxes paid | | – | – |
| **Net cash flows generated from operating activities** | | 107 | 36 |
| **Investing activities** | | | |
| Dividend received | | – | 400 |
| **Cash flows used in investing activities** | | – | 400 |
| **Financing activities** | | | |
| Drawdown of borrowings | | 90 | 109 |
| Interest paid | | (22) | (22) |
| Dividends paid | | (135) | (116) |
| **Cash flows used in financing activities** | | (67) | (29) |
| **Net increase in cash and cash equivalents** | | 40 | 407 |
| Cash and cash equivalents at the start of the year | | 594 | 187 |
| **Cash and cash equivalents at the end of the year** | | 634 | 594 |

The accompanying notes are an integral part of this Company cash flow statement.

# Company statement of changes in equity

For the year ended 31 March 2016

| | Notes | Share capital £m | Share premium £m | Retained earnings and other reserves £m | Total equity £m |
|---|---|---|---|---|---|
| At 1 April 2014 | | 1 | 684 | 219 | 904 |
| **Profit for the year** | | – | – | 433 | 433 |
| **Other comprehensive income** | | | | | |
| Items that may be reclassified to profit or loss: | | | | | |
| Loss on hedge of a financial instrument | | – | – | (5) | (5) |
| **Total other comprehensive expense** | | – | – | (5) | (5) |
| **Total other comprehensive income** | | – | – | 428 | 428 |
| **Transactions with the owners of the Company** | | | | | |
| Share-based payments reserve credit | | – | – | 4 | 4 |
| Equity dividends | 3 | – | – | (116) | (116) |
| At 31 March 2015 | | 1 | 684 | 535 | 1,220 |
| **Profit for the year** | | – | – | 9 | 9 |
| **Other comprehensive income** | | | | | |
| Items that may be reclassified to profit or loss: | | | | | |
| Gain on hedge of a financial instrument | | – | – | 2 | 2 |
| **Total other comprehensive income** | | – | – | 2 | 2 |
| **Total comprehensive income** | | – | – | 11 | 11 |
| **Transactions with the owners of the Company** | | | | | |
| Share-based payments reserve credit | | – | – | 5 | 5 |
| Share-based payments reserve debit | | – | – | (1) | (1) |
| Equity dividends | 3 | – | – | (135) | (135) |
| **At 31 March 2016** | | 1 | 684 | 415 | 1,100 |

The accompanying notes are an integral part of this Company statement of changes in equity.

# Notes to the Company financial statements

## 1. Accounting policies and basis of preparation

**Basis of preparation to transition to IFRS**

The Company has transitioned to IFRS as outlined within note 1 to the consolidated financial statements.

For all periods up to and including the year ended 31 March 2015, the Company prepared its financial statements in accordance with previously extant United Kingdom generally accepted accounting practice (UK GAAP). These financial statements, for the year ended 31 March 2016 are the first the Company has prepared in accordance with IFRS.

Accordingly, the Company has prepared individual financial statements which comply with IFRS applicable for periods beginning on or after 1 April 2015 and the significant accounting policies meeting those requirements are described in the relevant notes.

On transition to IFRS, the Company has applied the requirements of paragraphs 6 – 33 of IFRS1 'First Time Adoption of International Reporting Standards'.

In preparing these financial statements, the Company has started from an opening balance sheet as at 1 April 2014, the Company's date of transition to IFRS, and made those changes in accounting policies and other restatements required for the first time adoption of IFRS.

Following this preparation, there has been no material changes identified to the previously presented balance sheet under UK GAAP and no material change to other comprehensive income in adopting IFRS.

As a result, the transition to IFRS gives rise to no material reconciling items, therefore a third balance sheet is not presented. In addition, there are also no reconciling items within equity and total comprehensive income.

**Accounting policies**

The Company's accounting policies are in line with the Group's accounting policy as set out in note 1 of the Group consolidated financial statement. Where an accounting policy is generally applicable to a specific note, the policy is described within that note.

**Significant accounting judgements, estimates and assumptions**

There are no significant accounting judgements and estimates in preparing the Company financial statements.

## 2. Profit for the year

The Company reported a profit of £9m for the year ended 31 March 2016 (2015: £433m). This includes a dividend from a subsidiary of £nil (2015: £400m).

The auditor's remuneration for audit and other services is disclosed in the Corporate Governance Report on page 36.

Detailed disclosures of the Directors' remuneration and share-based payments are given in the audited section of the Directors' Remuneration Report on pages 46 to 55 and should be regarded as an integral part of this note.

In the current and prior year, the Directors' remuneration was borne by another Group company and not recharged.

The Company has no employees other than Directors.

## 3. Dividends

**Accounting policy**

Dividends receivable from the Company's subsidiaries and joint venture investments are recognised only when they are approved or paid by shareholders.

Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which they are approved by the Company's shareholders. Interim dividends are recognised in the period in which they are paid.

| | **2016 £m** | 2015 £m |
|---|---|---|
| Final dividend for the year ended 31 March 2014 of 8.00p per ordinary share | – | 74 |
| Interim dividend for the year ended 31 March 2015 of 4.60p per ordinary share | – | 42 |
| Final dividend for the year ended 31 March 2015 of 9.20p per ordinary share | 85 | – |
| Interim dividend for the year ended 31 March 2016 of 5.29p per ordinary share | 50 | – |
| **Total ordinary dividends(i)** | **135** | 116 |

(i) The proposed final dividend for the year ended 31 March 2016 of 10.58p (2015: 9.20p) per ordinary share on approximately 946 million (2015: 922 million) ordinary shares (approximately £100m) was approved by the Board on 12 May 2016 and has not been included as a liability as at 31 March 2016.

The Group ESOT has waived its rights to receive dividends in the current and prior year and this is reflected in the analysis above.

## 4. Investments

**Accounting policy**

Investments in subsidiaries and joint ventures are recorded at cost, being the fair value of consideration, acquisition charges associated with the investment and capital contributions by way of share-based payments, less any provision for impairment.

| | 2016 £m | 2015 £m |
|---|---|---|
| Subsidiaries | 1,161 | 1,157 |
| Joint venture | 35 | 27 |
| | 1,196 | 1,184 |

| | 2016 £m | 2015 £m |
|---|---|---|
| Opening net book value | 1,184 | 1,173 |
| Additions | 12 | 11 |
| Closing net book value | 1,196 | 1,184 |

**Joint ventures**

The Company holds 14.3% of the ordinary share capital of YouView TV Limited, a joint venture with The British Broadcasting Corporation, ITV Broadcasting Limited, British Telecom PLC, Channel Four Television Corporation, Arqiva Limited and Channel 5 Broadcasting Limited. Further details relating to the joint venture are disclosed within note 14 to the consolidated financial statements.

**Principal Group investments**

A full list of subsidiaries, joint arrangements, associated undertakings and any significant holdings (as defined in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008) is presented in note 13 of the Group consolidated financial statements.

**Additions**

The additions in the year comprise:

- £4m relating to share-based payment schemes issued by the Company (2015: £3m); and
- £8m relating to the YouView joint venture (2015: £8m).

## 5. Trade and other receivables

| | 2016 £m | 2015 £m |
|---|---|---|
| Amounts owed by Group undertakings | 8 | 74 |
| Prepayments and accrued income | 7 | 8 |
| | 15 | 82 |

Interest on intercompany funding is calculated at the Bank of England base rate plus 2%; intercompany deposits receive interest at the Bank of England base rate with no margin. Interest is either paid or capitalised monthly as appropriate. Where they exist, currency balances are calculated at similar rates.

Interest is not charged on balances arising between Group companies as a result of intercompany trading; such balances are settled regularly in line with agreed terms of trade within 30 to 60 days.

## 6. Trade and other payables

| | 2016 £m | 2015 £m |
|---|---|---|
| Amounts owed to Group undertakings | 53 | 35 |
| Accruals and deferred income | 2 | 2 |
| | 55 | 37 |

Interest on intercompany funding is calculated at the Bank of England base rate plus 2%; intercompany deposits receive interest at the Bank of England base rate with no margin. Interest is either paid or capitalised monthly as appropriate. Where they exist, currency balances are calculated at similar rates.

Interest is not charged on balances arising between Group companies as a result of intercompany trading; such balances are settled regularly in line with agreed terms of trade within 30 to 60 days.

# Notes to the Company financial statements continued

## 7. Borrowings

| | 2016 £m | 2015 £m |
|---|---|---|
| **Non-current** | | |
| Loans | 709 | 615 |
| | 709 | 615 |

The details of the loans are disclosed within note 18 to the consolidated financial statements and should be regarded as an integral part of these financial statements.

## 8. Share capital

| | 2016 million | 2015 million | 2016 £m | 2015 £m |
|---|---|---|---|---|
| **Allotted, called up and fully paid** | | | | |
| Ordinary shares of 0.1p each | 955 | 955 | 1 | 1 |

## 9. Reserves

**Share premium**

The share premium account records the difference between the nominal amount of shares issued and the fair value of the consideration received. The share premium account may be used for certain purposes specified by UK law, including to write off expenses incurred on any issue of shares or debentures and to pay up fully paid bonus shares. The share premium account is not distributable but may be reduced by special resolution of the Company's ordinary shareholders and with court approval.

**Other reserve – Group ESOT**

The Group ESOT held nine million shares at 31 March 2016 (2015: 33 million) in the Company for the benefit of employees. During the period, the Trustees of the Group ESOT reassessed their holdings in relation to the number of options expected to be exercised in the future. This resulted in the sale of 20m shares, generating net proceeds of £61m. The Group ESOT has waived its rights to receive dividends and none of its shares have been allocated to specific schemes. At the year end the shares had a market value of £22m (2015: £112m).

## 10. Audit exemption note

The Company is entitled to exemption from audit for its subsidiaries under Section 479A of the Companies Act 2006 for the year ended 31 March 2016.

The Directors have applied this exemption for the following subsidiaries:

| Company name | Company number |
|---|---|
| Executel Ltd | 05227052 |
| Greystone Telecom Ltd | 04066365 |
| Green Dot Property Management Limited | 05705868 |
| Tiscali UK Limited | 03408171 |

The Directors acknowledge their responsibility for complying with the requirements of the Companies Act 2006 with respect to accounting records and the preparation of accounts.

# Other information

# Five year record (unaudited)

| | **2016 £m** | 2015 £m | 2014 £m | 2013 £m | 2012 £m |
|---|---|---|---|---|---|
| **Headline results** | | | | | |
| Revenue | **1,838** | 1,795 | 1,727 | 1,670 | 1,687 |
| Profit for the year attributable to the owners of the Company | **79** | 76 | 61 | 132 | 159 |
| **Net assets** | | | | | |
| Non-current assets | **1,169** | 1,109 | 1,039 | 1,046 | 1,102 |
| Net current liabilities excluding provisions | **(224)** | (161) | (223) | (216) | (230) |
| Non-current liabilities excluding provisions | **(685)** | (616) | (460) | (375) | (410) |
| Provisions | **(29)** | (35) | (9) | (13) | (18) |
| Net assets | **231** | 297 | 347 | 442 | 444 |
| **Headline earnings per share** | | | | | |
| Basic (p) | **8.4** | 8.2 | 6.8 | 14.9 | 18.0 |
| Diluted (p) | **8.3** | 8.1 | 6.6 | 14.0 | 17.2 |
| **Statutory earnings per share** | | | | | |
| Basic (p) | **0.2** | 7.8 | 3.1 | 11.3 | 15.6 |
| Diluted (p) | **0.2** | 7.7 | 3.0 | 10.6 | 14.9 |

Headline earnings represent the Group's income statement stated before the non-operating amortisation and exceptional items.

# Glossary

| | |
|---|---|
| **ADSL** | Asymmetric Digital Subscriber Line technology enables data transmission over existing copper wiring at data rates several hundred times faster than analogue modems, providing for simultaneous delivery of voice, video and data |
| **ARPU** | Average Revenue Per User on a monthly basis |
| **CAGR** | Compound Annual Growth Rate |
| **CGU** | Cash generating unit |
| **Churn** | A measure of the number of subscribers moving into or out of a product or service over a specific period of time |
| **The Company** | TalkTalk Telecom Group PLC |
| **Companies Act** | Companies Act 2006 |
| **CPW** | The Carphone Warehouse Group PLC, its subsidiary companies, joint ventures and investments |
| **CRM** | Customer Relationship Management |
| **Demerger** | The demerger of the The Carphone Warehouse Group PLC into TalkTalk Telecom Group PLC and Carphone Warehouse Group PLC effective on 26 March 2010 |
| **DSLAM** | Digital Subscriber Line Access Multiplexer |
| **EBIT** | Earnings Before Interest and Taxation |
| **EBITDA** | Earnings Before Interest, Taxation, Depreciation and Amortisation |
| **EFM** | Ethernet in the First Mile |
| **EPS** | Earnings Per Share |
| **Ethernet** | Ethernet is a protocol that controls data transmission over a communications network often referred to as a family of frame-based computers |
| **Femto cells** | Small low power cellular base station |
| **FRC** | Financial Reporting Council |
| **FTTC** | Fibre to the Cabinet |
| **FTTP** | Fibre to the Premise |
| **Gbps** | Gigabits per second |
| **Guard band spectrum** | Unused part of the radio spectrum between adjacent radio bands |
| **GPS** | Global Positioning System |
| **The Group** | The Company, its subsidiaries and entities which are joint ventures |
| **Group ESOT** | TalkTalk Telecoms Holdings Employee Share Option Trust |
| **Headline information** | Headline information represents the Group's income statement, stated before the amortisation of acquisition intangibles and exceptional items that are considered to be one-off, non-recurring in nature and so material that the Directors believe that they require separate disclosure to avoid distortion of underlying performance and should be separately presented on the face of the income statement |
| **HD** | High Definition |
| **IP** | Internet Protocol is the packet data protocol used for routing and carriage of messages across the internet and similar networks. IP performs the addressing function and contains some control information to allow packets to be routed through networks |
| **ISP** | Internet Service Provider |
| **LLU** | Local Loop Unbundling |
| **Mbit/s/Mbps** | Unit of data transfer rate equal to 1,000,000 bits per second |

# **Glossary** continued

| | |
|---|---|
| **MPF** | Metallic Path Facility provides both broadband and telephony services to customers from TalkTalk Group exchange infrastructure |
| **MSAN** | Multi-Service Access Nodes |
| **MVNO** | Mobile Virtual Network Operator |
| **Narrowband** | Telecommunication service that carries voice information in a narrowband of frequencies |
| **Net debt** | Borrowings net of cash held on deposit at financial institutions |
| **NGN** | Next Generation Network |
| **On-net** | The Group's unbundled network |
| **Operating free cash flow** | Cash generated from operations before exceptional items, interest, taxation, dividend payments and investments |
| **Operating profit** | Profit before finance costs and taxation |
| **OTT** | Over the Top |
| **Quad play** | A customer that takes voice, broadband, TV and MVNO services from the Group |
| **RCF** | Revolving Credit Facility |
| **RGU** | Revenue generating unit |
| **SMPF or partial unbundling** | Shared Metallic Path Facility provides broadband services to customers from TalkTalk Group exchange infrastructure |
| **SME** | Small and Medium sized Enterprises |
| **SVP** | Shareholder Value Plan |
| **Triple play** | A customer that takes voice, broadband and TV services from the Group |
| **TSR** | Total Shareholder Return |
| **TVOD** | TV on Demand |
| **UK Corporate Governance Code** | UK Corporate Governance Code published by the FRC in May 2011 |
| **Unbundling** | Process by which BT makes available its local network to third party broadband service providers |
| **VES** | Value Enhancement Scheme |
| **VoIP** | Voice over Internet Protocol |
| **VNL** | Video Network Limited |
| **WAEP** | Weighted Average Exercise Price |
| **Wi-Fi** | Trademark of the Wi-Fi Alliance often used as a general term for wireless networking technology that uses radio waves to provide wireless high speed internet and network connections |

# Financial calendar

| | |
|---|---|
| Ex-dividend date | 7 July 2016 |
| Record date | 8 July 2016 |
| AGM | 20 July 2016 |
| Dividend payment date | 3 August 2016 |

# Advisers

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## TalkTalk Telecom Group PLC

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