

## OVERVIEW

We are pleased to present a review of another successful year for the Group, albeit framed by a difficult economic environment.

This has been a challenging period of trading for the Group, as average revenues of business customers have reduced as the economy has slowed. Due to the speed and depth of the slow down, particularly since January and February 2009, the impact of this reduction in customer spend has more than outweighed the impact of new customer wins. Moreover, the benefits of the cost-cutting initiatives implemented in the early spring only emerged in the second half. Throughout the period, the Group has continued to win market share and has generated very healthy cash returns, and the proposed increase in dividend reflects the Board's confidence in the underlying business.

## FINANCIAL RESULTS

Group sales decreased by 4% to £89.7m (2008: £93.7m). The differing product sets' results are analysed further below. Market share gains are being made in each product grouping, but these have been more than offset by revenue reductions due to lower customer usage, particularly in mobile services, and continuing price reductions for existing clients.

Gross profit margins are in line with expectations at 34.4% (2008: 35.0%), allowing for lower usage of higher margin revenues, due to diminished customer spend. Margins per product set are reviewed in detail below.

Adjusted operating profit of the Group reduced by 14% to £9.0m (2008: £10.4m).

On a statutory basis, pre-tax profits decreased 20% from £8.9m to £7.1m, with operating profits decreasing 20% from £8.8m to £7.0m.

Cash generation continues to be very strong and differentiates the Group from many of its peers. Net cash generated from operations was £10.6m (2008: £10.3m) which was 110% of adjusted EBITDA in the period (2008: 94%). Free cash flow was £7.9m (2008: £7.6m) enabling the Group to return a further £1.3m to shareholders during the year through a general share buy-back programme, and finished the year with £9.0m cash (2008: £4.2m).

Adjusted earnings per share fell 13% and 12% in basic and diluted earnings respectively to 14.4p and 13.9p respectively. Statutory earnings per share fell 16% from 14.3p to 12.0p. A detailed reconciliation is set out overleaf in the Financial and Business Review.



**JAMES MURRAY**  
CHIEF EXECUTIVE OFFICER

- Free cash flow was £7.9m (2008: £7.6m) enabling the Group to return a further £1.3m to shareholders during the year through a general share buy-back programme, and finished the year with £9.0m cash (2008: £4.2m).
- The Group has persistently pursued its twin strategy of organic and acquisitive growth with a stated ambition to become the leading converged communications partner of choice for the UK's small and medium sized businesses.
- However, the underlying success can be evidenced by the increase in the number of higher spending customers taking three or more products. The number of these customers has increased 10%.
- Our strategy has not wavered and, as we come into another year which offers similar economic uncertainty, we have a leaner platform and a stronger sales and service proposition than we did twelve months ago.

The Board has proposed a final dividend of 3.5p (2008: 3.1p), making a total of 5.1p for the year (2008: 4.6p), a growth of 11%, in line with our progressive dividend policy.

## STRATEGY

The Group has persistently pursued its twin strategy of organic and acquisitive growth with a stated ambition to become the leading converged communications partner of choice for the UK's small and medium sized businesses.

## ACQUISITIONS

The Group has reviewed a number of acquisition opportunities during the year, especially in the IT and data services space. The Group entered into the second round in around five competitive tenders, withdrew interest on two and were outbid on the remainder, which demonstrates our refusal to overpay. Since the year end, on 30 October 2009, we acquired the entire share capital of AKJ, currently our billing services partner, for a maximum consideration of £5.5m; the initial consideration consisting of £3.75m cash and £0.8m through the issue of 707,076 ordinary shares. The AKJ group is based in Chatham, Kent and has approximately 50 staff, of which 25 are IT developers. In the year ended 31 July 2009, AKJ increased sales by 4% to £3.6m, and the Group made a pre-tax profit of £0.3m and underlying EBITDA of £0.6m. The gross assets of the business were £2.3m. The acquisition is expected to be moderately earnings enhancing for the Group for the year ending 30 September 2010.

The deal is relatively small but strategically important for the Group. The rationale for the acquisition was set out in the original announcement on 2 November.

## CASE STUDY - SMITHS GORE



“In just over a year, Alternative Networks has helped us improve our effectiveness by introducing BlackBerry, taking over the entire mobile fleet and ultimately managing all Smiths Gore's outbound voice traffic. It has helped us really make the most of our telecoms, and we look forward to continuing to work with them.”

Briefly summarised, this was:

- The Group has used AKJ's software for almost ten years. We have invested considerable resource in applying it to provide customers with a bespoke, simple and efficient mechanism to access and control the billing and usage of their communications equipment. Bringing this software in house will protect the Group's intellectual property and guarantees exclusivity on key elements of the software that are important for customer attraction and retention.
- The acquisition will also accelerate the development of the Group's customer service portal, enhancing the existing service offering and creating opportunities for new revenue streams by working with third party telecoms and IT services providers.
- The acquisition provides a platform for potential new revenue streams working with third party telecoms and IT service providers. The Group intends to develop the portfolio of services and products that it can offer to European based telecoms and IT service providers, systems integrators, resellers and dealers, based on AKJ's platform. AKJ's current customers include over 50 communications and IT service providers and the combined portfolio of services and resources of the Group will create the opportunity for exciting new revenue streams for both the Group and AKJ's partners.

As ever, we remain focused on acquisitions that are the right fit and at the right price. We are confident that our strong balance sheet and net cash of over £4m as at the balance sheet date after funding the acquisition above, as well as our £12m undrawn bank debt facilities, keeps us in a strong position in the year ahead.

Smiths Gore is a leading rural property consultancy of chartered surveyors and property advisors. With over 160 years' experience, they are recognised as a dynamic and diverse business, managing over 2m acres of land in the UK alone. Over the last ten years they have grown both commercially and organically, resulting in the opening of new offices in key locations across the UK. They now operate from 25 offices and 18 estate offices confirming their position as a market leader in the rural land and property sector.

### AT THE OUTSET

- Smiths Gore acquired Cluttons Rural Division – an existing Alternative Networks client – in March 2008.
- Alternative Networks provided a fleet of BlackBerry smartphones.
- All other voice, mobile and support provided by Smiths Gore's incumbent provider.

### HOW WE GREW THE ACCOUNT

- Proving their commitment to Alternative Networks, between April 2008 and April 2009, mobile and BlackBerry fleet grew by 100 connections.
- In May 2009, all 200 mobile and BlackBerry connections are ported to Alternative Networks.
- Seeing the financial and administrative benefits of convergence, fixed line rental and all outbound voice is moved to Alternative Networks from BT Retail.

- A new Mitel telephone system is installed in one Yorkshire branch, with Alternative Networks responsible for the implementation and its annual support contract.

### FUTURE OPPORTUNITY

- There is the potential for further data services in this crucial environment.
- With the need for upgraded phone solutions comes the opportunity for both provision and maintenance of systems.
- Fixed mobile convergence could be a real driver of efficiency over the coming years.

## STRATEGY (CONTINUED) REVIEW OF ORGANIC GROWTH FACTORS – UPDATE ON KEY PERFORMANCE INDICATORS

The four key organic growth factors supporting our strategy remain:

### FOCUS ON LARGER CUSTOMERS IN SME SPACE

The target customer in the market for the Group remains the business customer who spends between £1,000 and £10,000 per month.

The underlying success of increasing the number of higher spending customers is shrouded by the economic downturn. Over the year, there has been a net reduction of 25 customers spending over £1,000 with the total number of Group customers spending over £1,000 per month being reduced to 1,249 at 30 September 2009 from 1,274 at 30 September 2008 (restated to eliminate duplication of Echo network customers). This net reduction has been caused by price erosion and decreases in traffic during the year pushing many customers below the £1,000 spend threshold.

However, the underlying success can be evidenced by the increase in the number of higher spending customers taking three or more products. The number of these customers has increased 10% by 66 to 722 customers.

### CROSS-SELLING

The Group has made solid progress in cross-selling the product set. Of the total customer base at 30 September 2009, over 40% took more than one product (2008: 36%).

Of all customers spending more than £1,000 per month, 75% (2008: 70%) took more than one product and, most encouragingly, 58% (2008: 50%) took three products or more. Mobile services are currently treated as one product whether data, voice or ancillary services.

### REDUCTION IN CHURN

2009 was a challenging year for reducing churn. Our key metric of mobile network subscriber churn was increased from 16.4% in 2008 to 19.7% in 2009, as more customers switched networks in search of better deals, and were more discerning in disconnecting surplus lines as they reduced headcount. Nonetheless this result remains in the Group's long held target band of 16–20%. Stripping out the increase in customers who switched networks but stayed with us, being around 1,400 connections, the network churn number is closer to 17%.

We also monitor customer attrition by value. This was much steadier and remained at a low level of 15% as also achieved in 2008.

### PRODUCT DEVELOPMENT

Our organic growth depends on widening our share of our customers' communications spend and we rely on using our strategic partnerships to consistently deliver new growth opportunities.

During the past year, our suppliers have each tried to bring their own unified communications ("UC") products to market; we have spent a lot of time with them establishing which ones fit into our portfolio, how they integrate with existing infrastructure, and reviewing the return on investment.

UC products launched, trialed, or evaluated include:

Supplier	Product	Status
Avaya	One-X	Launched
Mitel	Series-X, Unified Communicator Advanced, and Dynamic Extension	Launched
Cable & Wireless	FMC	Trial
Vodafone	One-net	Evaluation

A number of SIP trunking and Hosted IP telephony propositions are also in trial phase.

We look forward to bringing more of these products to market as we continue to improve our UC offering, and offer deeper and more flexible integration to our customers.

In the data space, we launched our offering of Cisco products, registering as a select partner, and gaining the assistance of a new contracted partner specialising in the more advanced UC arena, we have won our first customer.

Mobile communication has continued to be an area of vendor development:

The BlackBerry 8520 "Curve", a lower-priced edition of the popular 8900 device which shares many of the same features, was the first device to feature the more robust trackpad instead of the trackball. This device has been a great success due to the challenging economic conditions, and has allowed us to push BlackBerry connections further down the food chain within our customers.

New improved smartphones from HTC and Nokia both offering mobile applications to field operators, combined with the impending availability of the Apple “i-phone” through most mobile networks, and the revised models of the BlackBerry “Storm” and “Bold” should help drive further growth in the number of converged devices in our customer base and lead to increased data revenues.

Finally, a key focus has been on our customer billing and service portal, Clarity™. We launched a range of updates to Clarity™ our online billing, reporting and asset management tool. Most notably, we have developed the ability to separate out “business” from “personal” calls, and manage this process using a hosted database with automated sign off.

The Group has planned a 24 month development roadmap to bring many new services through an Alternative Networks’ branded portal to corporate customers, including estate management, diagnostics, hosted online services, and online interactive customer services. The acquisition of AKJ is expected to help deliver these faster and more effectively.

## **BUSINESS RESILIENCE**

Last year we reviewed the key characteristics of what makes this business so resilient: firstly, our strong balance sheet, strong cash flow, and low fixed asset base. Secondly we provide business critical services to a diverse number of UK businesses in a wide variety of industries. Finally, there is good visibility of future revenue streams as customers’ contracts typically last at least two years. We also discussed how our products would help our customers save money in a downturn. This was within the context of the Group having industry leading suppliers, and a strong management team that has consistently delivered organic growth over 10 years together. We set some targets for modest growth in sales and profits.

The resilience of our business model was truly tested in the financial year, following a fierce downturn in customer spend over January and February 2009, which has remained flat at best since then. We took appropriate action:

- We cut costs quickly to adjust to the broader economic conditions. Savings expected to be £2.5m over a full year were implemented without cutting too deep.
  
- We set some revised targets for the business, based around a cost improvement plan.

→ We have continued to win new business and have grown market share at the underlying level in all our product sets, albeit somewhat more slowly than previously. Winning major new accounts like Nestor Healthcare plc and Parfumes Christian Dior (UK) Limited, together with developing multi-product accounts like the Welsh Ambulance Service, MacMillan Cancer Support, Smiths Gore and Weightman solicitors have helped keep revenues at close to last year’s levels, as well as offering more potential in future years.

→ We have managed to cross-sell more products into our existing customer base, which is expected to improve loyalty.

→ We improved relations with key suppliers and that has helped keep margins in line with expectations in spite of the worse mix of revenues due to lower voice and data usage charges.

→ In August 2009, we decided to invest further in the growth of our public sector and health (“Blue Lights”) teams, recruiting sales, pre-sales and engineering expertise.

As a result of the above, we were able to achieve our revised targets. Our strategy has not wavered and, as we come into another year which offers similar economic uncertainty, we have a leaner platform and a stronger sales and service proposition than we did twelve months ago.

## **OUTLOOK**

Since the year end, we have acquired AKJ, which has sound strategic purpose, and we have won a multi-million pound contract from a major network operator to service 50 of their high spending SME customers. Both are contributing well to Group revenues.

We remain cautious in respect of our prospects of returning to rapid organic growth. This is due to the continued threat of a possible further dip in spending by existing customers, and is dependent on the recovery of the UK economy. However, in the longer term, as we move out of recession, we will have an opportunity to grow revenues more quickly. We anticipate this may be accompanied by further acquisitions offering complementary services to our existing products. We therefore remain excited over the prospects for future growth.

**JAMES MURRAY**  
**CHIEF EXECUTIVE OFFICER**  
7 DECEMBER 2009