Notes to the financial statements

for the year ended 31 March 2015

27 Financial instruments and risk management

The Group's principal financial instruments during the year comprised bank loans, cash on short-term deposits, interest rate swaps and forward foreign exchange contracts. The main purpose of these financial instruments is to finance the Group's operations, to manage the interest rate risk arising from its sources of finance and to minimise the impact of fluctuations in exchange rates on future cash flows. The Group has various other financial instruments such as short-term receivables and payables which arise directly from its operations.

The Group regularly reviews its exposure to interest, liquidity and foreign currency risk. Where appropriate the Group will take action, in accordance with a Board approved Treasury policy, to minimise the impact on the business of movements in interest rates and currency rates.

The Group only enters into derivative instruments with members of the banking group to ensure appropriate counterparty credit quality.

Liquidity risk

The Group keeps its short, medium and long-term funding requirements under constant review. Its policy is to have sufficient committed funds available to meet medium-term requirements, with flexibility and headroom to make minor acquisitions for cash if the opportunity should arise.

The Group's bank facilities were refinanced in June 2014 to replace existing facilities. These bank facilities comprise a multi-currency revolving credit facility of £200.0 million, provided by a group of five core relationship banks. The facility matures in June 2019. The Group considers that this facility will provide sufficient funding to meet the organic and inorganic investment needs of the business. In addition, short-term flexibility of funding is available under the £10.0 million overdraft facility provided by the Group's clearing bankers.

The net debt position of £75.0 million at the beginning of the financial year has increased during the year to net debt of £99.3 million. The Group generated positive cash flow after investing activities of £19.2 million for the year (2014: £44.0 million).

The table on page 89 analyses the Group's financial liabilities which will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. Notional interest is included for the period from the year end up to the contractual maturity date of the debt, calculated on the amount of debt drawn down at the year end.

	Less than one year £'000	One to three years £'000	Over three years £'000
At 31 March 2014			
Borrowings	2,604	85,868	—
Trade and other payables	123,139	—	—
Cash flow hedges	137	1,669	—
Total	125,880	87,537	—
At 31 March 2015			
Borrowings	1,734	3,465	107,146
Trade and other payables	106,832	—	—
Cash flow hedges	706	—	—
Finance leases	1,743	5,155	—
Total	**111,015**	**8,620**	**107,146**

The table below sets out the year end fair value of derivative financial instruments by category:

	2015		2014	
	Assets £'000	**Liabilities £'000**	Assets £'000	Liabilities £'000
Interest rate swaps – cash flow hedges	**—**	**706**	—	1,806
Forward foreign exchange contracts – cash flow hedges	**328**	**—**	—	—
Total	**328**	**706**	—	1,806
Less non-current portion:				
Interest rate swaps – cash flow hedges	**—**	**—**	—	1,669
Forward foreign exchange contracts – cash flow hedges	**—**	**—**	—	—
	—	**—**	—	1,669
Current portion	**328**	**706**	—	137

Notes to the financial statements continued

for the year ended 31 March 2015

27 Financial instruments and risk management continued

Interest rate risks

Sterling interest rate swaps were held during the year that fixed approximately 65% (2014: 80%) of the year end net debt excluding finance leases. The weighted average fixed interest rate payable (including margin) was 3.6% (2014: 3.90%). The weighted average rate of current interest rate swaps in place at the year end was 2.71% (excluding margin). Maturity dates of the current interest rate swaps are all July 2015 and reflect the forecast profile of net debt over the period. The weighted average period over which the interest rates are fixed is 0.33 years (2014: 1.3 years). Interest rate exposures will continue to be hedged in accordance with the Treasury policy.

The impact of an increase in interest rates of 100 basis points is shown in the table below:

	2015 £'000	2014 £'000
Reduction/(increase) in profit before tax	**327**	(150)

The sensitivity of profit before tax is calculated based on floating rate borrowings at the balance sheet date, after deducting floating rate financial assets and amounts hedged into fixed rates by interest rate swaps.

Foreign currency risk

Cash flow exposure

The Group's only major foreign currency risk arises due to the purchase of equipment invoiced in US Dollars. Whenever possible the Group resells this equipment in US Dollars. The remaining exposure is managed principally through the use of forward foreign exchange contracts in order to minimise the impact of fluctuations in exchange rates on future cash flows and gross margin.

The Group also has some Euro cash flows but these are not material on a net basis and are not hedged.

Net asset exposure

The Dollar denominated trading described above results in a balance sheet exposure since debtor days are longer than creditor days. It is the Group's policy not to hedge this exposure.

Credit risk

Credit risk arises from cash and cash equivalents and derivative financial instruments, as well as credit exposures to business and retail customers.

Credit ratings of institutions which hold the Group's financial assets are regularly monitored to ensure they meet the minimum credit criteria set by the Board through the Group Treasury policy. At the year end all the institutions holding the Group's financial assets were rated A-/A- or higher by Standard and Poor's.

The credit quality of customers is assessed by taking into account their financial position, past experience and other factors. Individual risk limits are set and the utilisation of credit limits monitored regularly.

The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. For an analysis of the quality of the ageing of the Group's trade receivables, see Note 19 for further disclosures.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. The Group does not hold any collateral as security.

Currency and interest rate risk profile of financial assets and financial liabilities

Financial assets

The Group had net financial assets of £11.0 million at the year end (2014: £9.4 million), comprising cash on overnight money market deposits and cash at bank. This attracts floating rates of interest.

The currency profile of the Group's financial assets at 31 March 2015 and 31 March 2014 was:

	2015 £'000	2014 £'000
Currency		
Sterling	**12,052**	7,955
US Dollar	**(1,572)**	909
Euro	**530**	577
Total	**11,010**	9,441

Foreign currency cash balances are held on a short-term basis to fund cash flow requirements in these currencies. All trade receivable balances are held in sterling and bear no interest. There is no currency risk associated with these balances.

At the year end £1.3 million (2014: £1.3 million) of cash collateral was held by Barclays in respect of a bank guarantee given under Ofcom's 'Funds for Liabilities' regulations.

Notes to the financial statements continued

for the year ended 31 March 2015

27 Financial instruments and risk management continued

Currency and interest rate risk profile of financial assets and financial liabilities continued

Financial liabilities

The currency and interest rate risk profile of the Group's financial borrowings at 31 March 2015 and 31 March 2014 was:

	2015			2014		
	Floating £'000	Fixed £'000	Total £'000	Floating £'000	Fixed £'000	Total £'000
Sterling	**43,460**	**60,000**	**103,460**	24,417	60,000	84,417

Undrawn committed borrowing facilities at the year end were £95.0 million (2014: £115.0 million).

Interest on amounts drawn under the committed borrowing facility is based on the relevant LIBOR plus margin. All trade payable balances are held in sterling and bear no interest. There is no currency risk associated with these balances.

Fair values of financial assets and financial liabilities

The mark-to-market value of the interest rate swaps and forward contracts at 31 March 2015 was an asset of £0.4 million (2014: liability of £1.0 million). Interest rate swaps are accounted for by adjusting the interest cost on the floating debt return. The fair value of financial assets and financial liabilities is obtained from third party sources. The movement in mark-to-market value is reflected in reserves and is shown in the table below:

	£'000
Hedging reserve	
31 March 2014	(986)
Movement in the year	1,428
31 March 2015	**442**

The effectiveness of the interest rate swaps was tested quarterly throughout the period, and at the year end, and all are considered to be effective cash flow hedges. There are no other significant differences between the fair value of the Group's financial assets and liabilities and their book value.

IFRS 7 requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2); and
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

All of the Group's financial instruments fall into hierarchy level 2.

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern, support the growth of the business and maintain an optimal capital structure to reduce the cost of capital.

Consistent with others in the industry, the Group monitors capital on the basis of its gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the Consolidated balance sheet) less cash and cash equivalents.

Total capital is shown in the table below and is calculated as 'equity' as shown in the Consolidated balance sheet plus net debt.

	2015 £'000	2014 £'000
Net debt	**99,348**	74,976
Total equity	**68,879**	85,153
Total capital	**168,227**	160,129

Under the Group's £200 million revolving credit facility the Group is required to comply annually with certain financial and non-financial covenants. The Group is required to maintain a minimum interest cover ratio and a maximum net debt to EBITDA ratio. Both financial covenants were tested and complied with throughout the year and at the year end. The Board monitors both covenant compliance and net debt performance on a regular basis.