

Focusrite

Making music easy to make

Focusrite Plc
Interim Report
Six months to 28 February 2017

Introduction

Focusrite is a global music and audio technology group, supplying hardware and software solutions to musicians and sound professionals.



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Business Highlights

"We have enjoyed another period of significant growth. We strive to develop further innovative market-leading products and to be the most recognised brand in our market place. In these aims, our people continue to be our key asset and I am delighted that we have now hired Tim Carroll as the Group's new CEO to guide us through our next phase of development. I am confident that the future of the Group remains in good hands."

Philip Dudderidge,
Focusrite Executive Chairman

"We have firmly established ourselves as a market leader and our aim is to capitalise further on this by continuing to excite and empower our customers. By improving the product and customer experience, we will seek to extend the customer lifecycle, keeping them using our products longer throughout their music making lifetime."

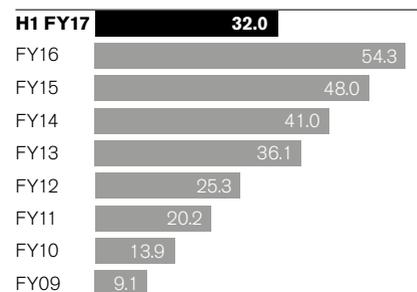
Since the half year end, revenue and cash have both continued to grow strongly. The new products introduced in the period and the second generation of our market-leading Scarlett range continue to sell well, and we look forward with confidence to the second half of the current financial year and beyond."

Tim Carroll,
CEO

Financial Highlights

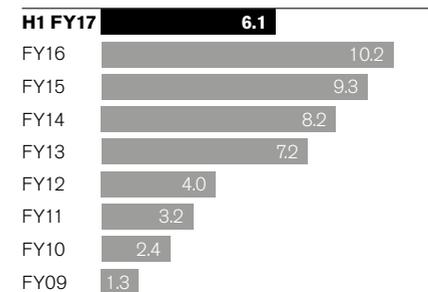
Group revenue

£million



Adjusted EBITDA¹

£million



1 Comprising of earnings adjusted for interest, taxation, depreciation, amortisation and non-underlying items.

Business and Operating Review

Overview

Focusrite is pleased to report interim results that show continued strong organic growth across all our key financial metrics. Year-on-year growth in the first half of the current financial year continued with revenue growing by 23.7%.

Total revenue for the period grew to £32.0 million (HY16: £25.9 million), resulting in an operating profit of £4.6 million (HY16: £3.2 million), with adjusted EBITDA up to £6.1 million (HY16: £4.8 million). This growth was driven by a number of factors, including a strong performance in our Novation business, as well as continued growth of the second generation Scarlett USB audio interface range. Notwithstanding the benefit of recent currency trends, revenue growth on a constant currency basis accelerated further to 12% (FY16: 7.5%).

Research and development remains the engine room of our growth, and six new products were launched during the period across a range of price points and market segments. Further progress was also made within our existing product base, most notably strong sales of our Launchpad product from Novation, which was driven by greater market awareness and the increased adoption of grid controllers, particularly among younger customers.

Sales grew in all regions, but importantly to the USA, which is our largest market, grew by 25% on a constant currency basis³.

Our strategy of innovation and expansion continues to underpin our growth and we remain committed to making music easier to make for professionals and hobbyists alike. Our success is driven by our entrepreneurial and pioneering team, many of whom are themselves musicians and their skill and loyalty is the bedrock of our success. The team now has new leadership, following the appointment of Tim Carroll as Chief Executive Officer. Tim, a former professional musician, has enjoyed a distinguished career in the industry, most notably with Avid Technologies, and we look forward to a bright future with him as he works with the executive team to execute on our strategic goals.

Financial highlights for the six months ended 28 February 2017

- Strong organic growth across all key financial metrics and KPIs
- Group revenue up by 23.7% to £32.0 million (HY16: £25.9 million)
- Adjusted EBITDA¹ up by 27.2% to £6.1 million (HY16: £4.8 million)
- Operating profit up by 44.9% to £4.6 million (HY16: £3.2 million)
- Profit before tax up by 89.1% to £4.6 million (HY16: £2.4 million)
- Basic earnings per share 7.3p, up by 82.5% (HY16: 4.0p)
- Adjusted² diluted earnings per share 7.0p, up by 52.2% (HY16: 4.6p)
- Net cash of £9.4 million (HY16: £4.0 million)
- Interim dividend of 0.75p, up 15.4% from 0.65p in HY16

1 Comprising of earnings adjusted for interest, taxation, depreciation, amortisation and non-underlying items.

2 Adjusted for non-underlying items which were £nil in HY17 and £0.5 million legal costs in HY16.

3 Where we make reference to constant currency growth rates, these are prepared by retranslating the current year revenues using exchange rates that prevailed in the prior year rather than the actual exchange rates that applied in the current year.



Focusrite

The number one
audio interface
brand in the world

Business and Operating Review continued

Operating review

We continue to exceed our core growth KPI benchmarks and the Group continues to perform well both operationally and financially. The management team is committed to pursuing its stated goals of innovation; disruption; making music easier to make; and expanding our addressable market. We have firmly established ourselves as a market leader and our aim is to capitalise further on this by continuing to excite and empower our customers. By improving the product and customer experience, we will seek to extend the customer lifecycle, keeping them using our products longer throughout their music making lifetime.

Segmental analysis – markets

	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Continuing operations			
USA	13,246	9,069	21,382
Europe, Middle East and Africa	12,958	12,064	22,582
Rest of World	5,816	4,747	10,337
Consolidated revenue	32,020	25,880	54,301

Regionally, the USA grew by 25% on a constant currency basis. This was driven by a number of factors, including significant growth against a weaker comparable period in our Novation segment, as well as a continued acceleration of demand for our commercial/pro audio RedNet products, which enable numerous high-quality audio signals to be distributed via 'Audio over IP' based technology. These products are targeted at the live sound and broadcast business-to-business market, and it is an area where we hope to make more inroads in the coming years. Widespread acceptance and strong sales of our second generation Scarlett USB audio interface range also contributed to the overall growth.

In Europe, Middle East and Africa, sales were up by 5% on a constant currency basis. This growth was achieved despite facing tough competition and experiencing some reductions in distributor stocks of Focusrite products. Within the region, UK revenue grew by 16%, boosted by Amazon, which is now 13% of the EMEA region.

The Rest of World grew at 8% on a constant currency basis, with Asia in particular showing a healthy increase following our investment in establishing an office there. Within Asia, China is growing and Japan and South Korea both declined. Asia remains a key focus for the management team and, as we become more established there, we will seek to expand further, adding to the team in the year ahead. Similarly, Latin America is another region of significant interest for the Group as a potential area of growth, which to date has remained a largely untapped market.

Segmental analysis – products

	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Revenue from external customers			
Focusrite	20,856	16,946	37,563
Novation	9,604	7,287	13,683
Distribution	1,560	1,647	3,055
Total	32,020	25,880	54,301

Alongside engineering, innovation is paramount to success and we continue to spend between 6% and 7% of revenue on research and development so as to provide a constant stream of new and relevant products for our various channels.

We launched six new products during the period namely: Red 8 Pre, Clarett Octopre, Scarlett Octopre, Scarlett Octopre Dynamic, iTrack One Pre, Launch Control XL MK2, as well as a Circuit Components Update. These new products are across different price segments and target customer markets, giving us further penetration and reach. Feedback from the consumer, retailer and distribution channels has been positive and acceptance so far has been pleasing.

Focusrite

Among existing products, our second generation Scarlett USB audio interface range has continued to gain market share since its launch in June 2016. The Clarett and Red brands have also shown good growth, albeit slightly lower than expected, due to price competition from established competitor brands in the more mature markets. Management has identified this trend and continues to watch it closely with a view to taking a more proactive stance if required.

Our commercial and pro audio segment, led by RedNet, is gaining momentum as applications for its use and potential customers grow, especially in post-production, education and broadcast segments.

Novation

Launchpad, Novation's grid instrument that comes pre-loaded with Ableton Live Lite software, has shown a significant worldwide uplift in demand, with sales quantity increasing by 40% over the period. This is due in part to a wider market acceptance of grid controllers, especially amongst younger musicians and the addition of Amazon to the distribution channel. This move has created greater reach into both new and existing mainstream audiences. Online sales remain an area of importance for the Group, as we seek to stay relevant to the way consumers shop and spend.

Additionally, within the Novation business, Launchkey, the easy-to-use MIDI keyboard controller, has benefitted from the success of Launchpad. As music making increasingly becomes digital and portable, innovative and cutting edge products such as these can capture the imaginations of musicians and allow them to create wherever they might be and at a touch of a button.

Circuit, the inspirational grid-based groove box, continues to establish itself in the market. We are pleased with its progress, but believe that there is an opportunity to define the scope of this product better to improve its alignment with market demand.

Business and Operating Review continued

The London app team continues to support the Novation brand with the Launchpad app, which has now reached an impressive 6,000,000 downloads, with downloads increasing at approximately 100,000 per month. The Blocs Wave app is entering a new phase of its development, moving towards a 'freemium' model (in which the initial download of the app is free but further sound and feature packs are charged for). We hope this will encourage users, who might not be interested in music making, to begin their journey to creativity and so develop an interest that can be commercialised in the future. A number of app and software updates have been introduced and the total number of active users across both platforms is now in excess of 500,000. The division is operating at broadly breakeven and we will continue to invest further as we believe it offers significant potential for both disruption and differentiation for the future.

Distribution and logistics initiatives

Focusrite's distribution of adjacent products, such as KRK monitors and sE microphones, remains a small overall proportion of Group revenue, but it is profitable and stable. It remains important to us as it offers add-on products within the music making industry and provides us with invaluable market feedback, insight and knowledge.

eCommerce initiatives

The Group's eCommerce store, which launched in March last year, now accounts for over 1% of the Group's revenue and this continues to grow. Initially, the store was created to sell refurbished products ('B stock') direct to end-users. In fact, the store creates improved conversion through all sales channels so, subsequently, we have expanded it and it now ships a wider range of products globally, with targeted regional strategies in place to support operations.

Financial review

Revenue and profit

Group revenue increased to £32.0 million, up 23.7% on the previous year and up 12% on a constant currency basis. This was driven principally by an improved performance at Novation, as well as continued strong sales from the next generation of Scarlett, and was underpinned by strong sales of existing products.

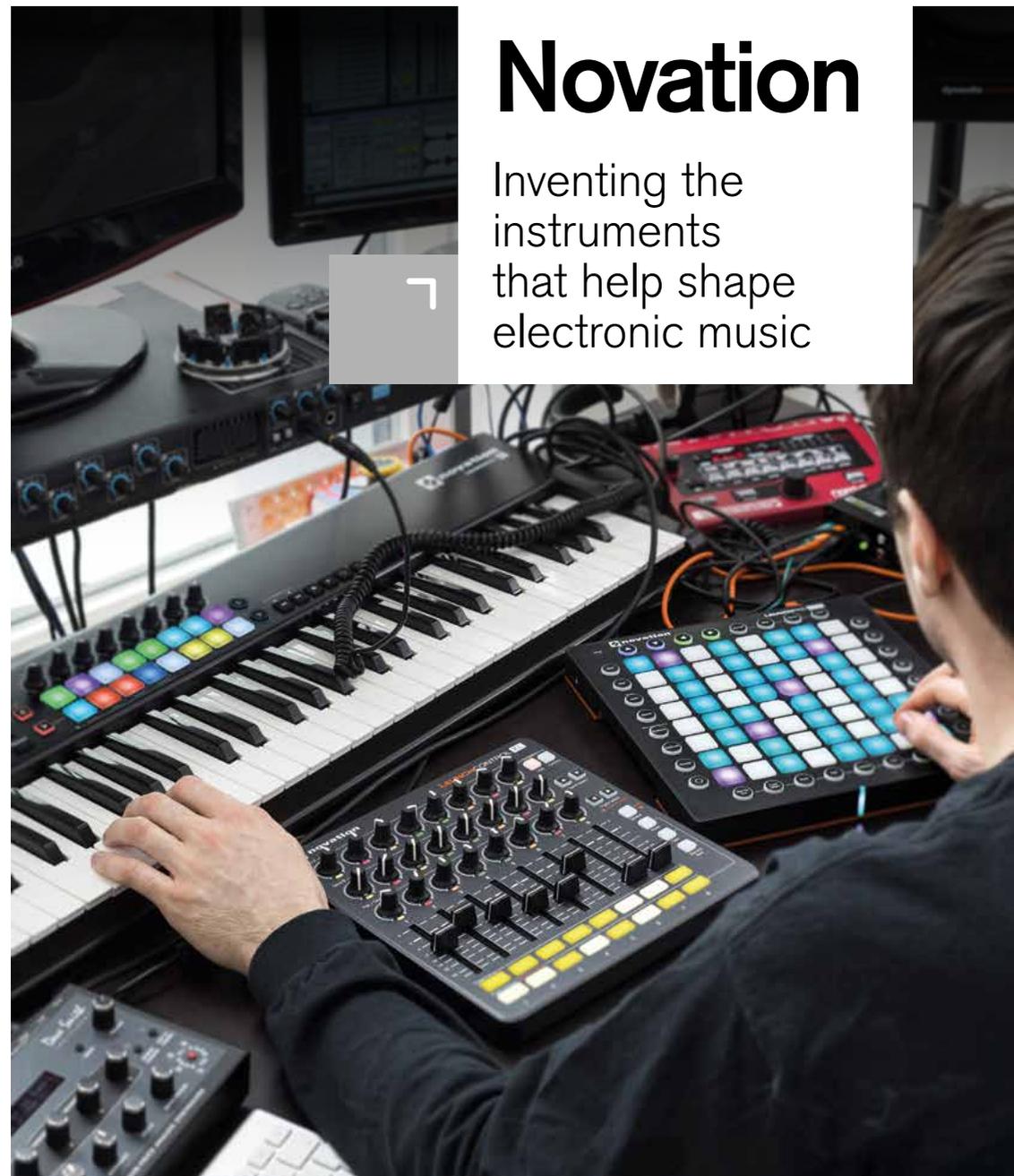
Pleasingly, despite the higher purchase prices of product caused by the strength of the US Dollar, the Group maintained a similar gross margin as in the previous year at around 40.1% (HY16: 39.8%). This was, in part, due to actions taken by management, including price increases and tighter discount controls. Operating costs were increased at a rate lower than the revenue growth and therefore adjusted EBITDA for the period grew by 27.2% to £6.1 million (HY16: £4.8 million).

Brexit and foreign currency

Exchange rates	Six months to 28 February 2017	Six months to 29 February 2016	Year to 31 August 2016
Average \$:£	1.26	1.50	1.45
Average €:£	1.16	1.37	1.29
Period end \$:£	1.24	1.43	1.31
Period end €:£	1.17	1.29	1.18

Novation

Inventing the instruments that help shape electronic music



Business and Operating Review continued

The Group experienced no significant impact on demand for its products as a result of the Brexit vote in the UK. However, the resulting volatility in the foreign exchange markets had the following effects:

- A stronger US Dollar against Sterling led to a higher cost of sales, but was largely offset by higher US Dollar sales as a result of the strong operating performance in the USA and Asia. As referred to above, we did experience some gross margin pressure caused by higher product cost, but this was countered by management increasing selling prices.
- A stronger Euro (the relevant currency for approximately a quarter of Group revenue) led to higher Sterling revenue without a significant matching cost increase. Overall, the Group's hedging policy is to hedge 75% of Euro flows one financial year in advance and, for FY17, the exchange rate is €1.28. The fact that this hedged rate was higher than the average Euro rate for the period reduced the revenue benefit of the stronger Euro. This policy has now been extended to include approximately 50% coverage for the following financial year (FY18) at a rate of €1.14.

Net financing charges

Last year, the movement in fair value of hedging contracts was disclosed as the major part of the net financing charges in the income statement and was a charge of £0.8 million. As disclosed in the Annual Report for FY16, the Group has now adopted hedge accounting and, consequently, the movement in fair value of the foreign exchange hedging contracts has been disclosed in reserves.

Non-underlying costs

The Group did not experience any non-underlying costs in this period. The legal cases relating to intellectual property and distribution contracts, for which a provision of £0.5 million was made last year, have now been settled.

Profit before tax

Overall, as a result of the higher revenue, improved margin, lack of non-underlying costs and application of hedge accounting, reported profit before tax almost doubled to £4.6 million (HY16: £2.4 million).

Tax

The Group gains tax credits on research and development as well as tax relief from the vesting of share options. Consequently, the effective tax rate has been estimated to be 12% for the period, which is lower than the standard Corporation Tax rate in UK.

Profit after tax and earnings per share

After all of the above factors have been considered, profit after tax increased by 89.1% to £4.0 million (HY16: £2.1 million).

The number of shares in issue remained at 58.075 million, so the reported basic earnings per share increased by 82.5% to 7.3 pence (HY16: 4.0 pence). Changes in the number of share options outstanding meant that the adjusted diluted earnings per share increased by 52.2% to 7.0 pence (HY16: 4.6 pence).

Balance sheet

Non-current assets relate largely to capitalised research and development costs. In this period, the research and development costs totalled approximately 6% of revenue and 75% of this was capitalised. The amortisation period is three years.

The value of stock held was reduced to £10.1 million at the period end, compared with £11.4 million as at 31 August 2016. This reduction was despite the increases in both volume and exchange rate and reflects the stabilisation of demand for new recently introduced products and a stronger internal focus on the management of working capital.

Debtors totalled £10.2 million, down from £11.2 million at 31 August 2016. A high proportion of debts continue to be paid on time and this reduction in the reported period was helped by customers who bought the first batch of the second generation of Scarlett products paying during September and October.

Trade and other payables were reduced from £8.6 million in August 2016 to £6.4 million in February 2017.

Cash flow

The business remains highly cash generative and cash management remains a key focus for the executive team. During the period, significant efforts were made to manage working capital and the overall movement in working capital was virtually zero, despite the strong increase in revenue.

In particular, cash flow from operating activities was 101% of EBITDA and free cash flow was 13% of revenue, both strong. As a result, cash balances grew from £5.6 million in August 2016 to £9.4 million as at 28 February 2017.

Dividend

The Group has a progressive dividend policy in place and the Board has approved a rise in interim dividend of 15% from 0.65 pence to 0.75 pence.

Outlook and current trading

Since the half year end, revenue and cash have both continued to grow strongly. The new products introduced in the period and the second generation of our market-leading Scarlett range continue to sell well and we look forward with confidence to the second half of the financial year and beyond.

Tim Carroll

Chief Executive Officer

Jeremy Wilson

Chief Financial Officer

Condensed Consolidated Income Statement

For the six months ended 28 February 2017

	Note	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Revenue	2	32,020	25,880	54,301
Cost of sales		(19,165)	(15,575)	(33,439)
Gross profit		12,855	10,305	20,862
Administrative expenses		(8,284)	(7,150)	(13,722)
Adjusted EBITDA (non-GAAP measure)		6,131	4,821	10,249
Depreciation and amortisation		(1,560)	(1,129)	(2,572)
Adjusted operating profit		4,571	3,692	7,677
Non-underlying items		–	(537)	(537)
Operating profit		4,571	3,155	7,140
Finance income		52	2	325
Finance costs		(24)	(725)	(339)
Profit before tax		4,599	2,432	7,126
Income tax expense	4	(552)	(292)	(870)
Profit for the period from continuing operations		4,047	2,140	6,256
Earnings per share				
From continuing operations				
Basic (pence per share)	7	7.3	4.0	11.8
Diluted (pence per share)	7	7.0	3.7	10.7

Condensed Consolidated Statement of Other Comprehensive Income

For the six months ended 28 February 2017

	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Profit for the period	4,047	2,140	6,256
<i>Items that may be reclassified subsequently to the income statement</i>			
Exchange differences on translation of foreign operations	29	38	45
Gain/(loss) on forward foreign exchange contracts designated and effective as a hedging instrument	700	–	(1,143)
Tax on hedging instrument	(142)	–	229
Total comprehensive income for the period	4,634	2,178	5,387
Profit attributable to:			
Equity holders of the Company	4,634	2,178	5,387
	4,634	2,178	5,387

Condensed Consolidated Statement of Financial Position

	28 February 2017 (unaudited) £'000	29 February 2016 (unaudited) £'000	31 August 2016 (audited) £'000
Note			
Assets			
Non-current assets			
Goodwill	419	419	419
Other intangible assets	4,823	4,006	4,373
Property, plant and equipment	1,502	1,416	1,575
Total non-current assets	3 6,744	5,841	6,367
Current assets			
Inventories	10,145	10,732	11,361
Trade and other receivables	10,234	9,809	11,224
Cash and cash equivalents	8 9,391	3,952	5,606
Total current assets	29,770	24,493	28,191
Total assets	36,514	30,334	34,558
Equity and liabilities			
Capital and reserves			
Share capital	58	58	58
Merger reserve	14,595	14,595	14,595
Merger difference reserve	(13,147)	(13,147)	(13,147)
Translation reserve	68	32	39
Hedging reserve	(356)	-	(914)
Treasury reserve	(3)	(5)	(5)
Deferred tax reserve	303	-	333
Retained earnings	27,125	18,705	22,918
Equity attributable to owners of the Company	28,643	20,238	23,877
Total equity	28,643	20,238	23,877
Current liabilities			
Trade and other payables	6,390	8,745	8,612
Current tax liabilities	523	-	644
Derivative financial instruments	8 443	562	1,143
Total current liabilities	7,356	9,307	10,399
Non-current liabilities			
Deferred tax	515	789	282
Total liabilities	7,871	10,096	10,681
Total equity and liabilities	36,514	30,334	34,558

Condensed Consolidated Statements of Changes in Equity

For the six months ended 28 February 2017

	Share capital £'000	Merger reserve £'000	Merger difference reserve £'000	Translation reserve £'000	Deferred tax reserve £'000	Hedging reserve £'000	Treasury share reserve ¹ £'000	Share-based payment reserve £'000	Retained earnings ² £'000	Total £'000
Balance at 1 September 2016	58	14,595	(13,147)	39	333	(914)	(5)	382	22,536	23,877
Profit for the period	-	-	-	-	-	-	-	-	4,047	4,047
Other comprehensive income for the period	-	-	-	29	-	558	-	-	-	587
Total comprehensive income for the period	-	-	-	29	-	558	-	-	4,047	4,634
Transactions with owners of the Company:										
Share-based payment deferred tax deduction in excess of remuneration expense	-	-	-	-	(30)	-	-	-	-	(30)
Share-based payment current tax deduction in excess of remuneration expense	-	-	-	-	-	-	-	-	556	556
Shares from EBT exercised	-	-	-	-	-	-	2	-	250	252
Share-based payments	-	-	-	-	-	-	-	75	-	75
Dividends paid	-	-	-	-	-	-	-	-	(721)	(721)
Balance at 28 February 2017	58	14,595	(13,147)	68	303	(356)	(3)	457	26,668	28,643

- The reserve for the Company's treasury shares comprises the cost of the Company's shares held by the Group. At 28 February 2017, the Employee Benefit Trust held 2,586,845 of the Company's shares (six months ended 29 February 2016: 4,627,861).
- Of the retained earnings totalling £26,668,380, £421,311 (29 February 2016: £151,980) relates to the gain on exercise of share options from the EBT and is therefore non-distributable.

Condensed Consolidated Statements of Changes in Equity continued

For the six months ended 29 February 2016

	Share capital £'000	Merger reserve £'000	Merger difference reserve £'000	Translation reserve £'000	Treasury share reserve £'000	Share-based payment reserve £'000	Retained earnings £'000	Total £'000
Balance at 1 September 2015	58	14,595	(13,147)	(6)	(6)	262	16,722	18,478
Profit for the period	-	-	-	-	-	-	2,140	2,140
Other comprehensive income for the period	-	-	-	38	-	-	-	38
Total comprehensive income for the period	-	-	-	38	-	-	2,140	2,178
Transactions with owners of the Company:								
Shares from EBT exercised	-	-	-	-	1	-	153	154
Share-based payments	-	-	-	-	-	60	-	60
Dividends paid	-	-	-	-	-	-	(632)	(632)
Balance at 29 February 2016	58	14,595	(13,147)	32	(5)	322	18,383	20,238

For the year ended 31 August 2016

	Share capital £'000	Merger reserve £'000	Merger difference reserve £'000	Translation reserve £'000	Deferred tax reserve £'000	Hedging reserve £'000	Treasury share reserve £'000	Share-based payment reserve £'000	Retained earnings £'000	Total £'000
Balance at 1 September 2015	58	14,595	(13,147)	(6)	-	-	(6)	262	16,722	18,478
Profit for the period	-	-	-	-	-	-	-	-	6,256	6,256
Other comprehensive income for the period	-	-	-	45	-	(914)	-	-	-	(869)
Total comprehensive income for the period	-	-	-	45	-	(914)	-	-	6,256	5,387
Transactions with owners of the Company:										
Share-based payment deferred tax deduction in excess of remuneration expense	-	-	-	-	333	-	-	-	-	333
Share-based payment current tax deduction in excess of remuneration expense	-	-	-	-	-	-	-	-	363	363
Shares from EBT exercised	-	-	-	-	-	-	1	-	171	172
Share-based payments	-	-	-	-	-	-	-	120	-	120
Dividends paid	-	-	-	-	-	-	-	-	(976)	(976)
Balance at 31 August 2016	58	14,595	(13,147)	39	333	(914)	(5)	382	22,536	23,877

Consolidated Statement of Cash Flow

For the six months ended 28 February 2017

	Six months to 28 February 2017 £'000	Six months to 29 February 2016 £'000	Year to 31 August 2016 £'000
Cash flows from operating activities			
Profit for the period before non-underlying items	4,047	2,677	6,793
Non-underlying items	5	(537)	(537)
Profit for the period	4,047	2,140	6,256
Adjustments for:			
Income tax expense	552	292	870
Net finance (income)/charge	(28)	723	14
Loss on disposal of property, plant and equipment	8	-	-
Amortisation of intangibles	1,198	914	2,051
Depreciation of property, plant and equipment	362	215	521
Share-based payment charge	75	60	120
Operating cash flow before movements in working capital	6,214	4,344	9,832
Decrease/(increase) in trade and other receivables	990	(1,988)	(3,487)
Decrease/(increase) in inventories	1,216	(2,099)	(2,728)
(Decrease)/increase in trade and other payables	(2,222)	339	206
Operating cash flow before interest and tax paid	6,198	596	3,823
Cash outflow in respect of non-underlying items	-	90	188
Operating cash flow before non-underlying items, interest and tax paid	6,198	686	4,011
Net interest paid	(22)	(89)	(111)
Income tax paid	(56)	(732)	(165)
Cash generated by operations	6,120	(225)	3,547
Net foreign exchange movement	78	189	365
Net cash inflow/(outflow) from operating activities	6,198	(36)	3,912
Cash flows from investing activities			
Purchases of property, plant and equipment	(299)	(308)	(773)
Development of intangible assets	(1,645)	(1,399)	(2,902)
Net cash used in investing activities	(1,944)	(1,707)	(3,675)
Cash flows from financing activities			
Issue of equity shares	252	154	172
Equity dividends paid	(721)	(632)	(976)
Net cash used in financing activities	(469)	(478)	(804)
Net increase/(decrease) in cash and cash equivalents	3,785	(2,221)	(567)
Cash and cash equivalents at beginning of year	5,606	6,173	6,173
Cash and cash equivalents at end of year	9,391	3,952	5,606

Notes to the Condensed Consolidated Interim Financial Statements

1. Basis of preparation and significant accounting policies

Focusrite Plc (the 'Company') is a company incorporated in the UK. The condensed consolidated interim financial statements ('interim financial statements') as at and for the six months ended 28 February 2017 comprised the Company and its subsidiaries (together referred to as the 'Group').

The Group is a business engaged in the development, manufacture and marketing of professional audio and electronic music products.

Statement of compliance

The condensed interim consolidated financial statements ('the interim financial statements') are for the six months ended 28 February 2017 and are presented in pounds Sterling ('GBP'). This is the functional currency of the Group. The interim financial report has been prepared in accordance with the International Financial Reporting Standards ('IFRS'), International Accounting Standards ('IAS') and interpretations currently endorsed by the International Accounting Standards Board ('IASB') and its committees as adopted by the EU and as required to be adopted by AIM listed companies. AIM listed companies are not required to comply with IAS 34 'Interim Financial Reporting' and accordingly the Company has taken advantage of this exemption. They do not include all the information required for a complete set of IFRS financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Group's financial position and performance since the last annual consolidated financial statements as at and for the year ended 31 August 2016.

These interim financial statements were authorised for issue by the Company's Board of Directors on 3 May 2017.

Significant accounting policies

The interim financial statements have been prepared in accordance with the accounting policies adopted in the Group's financial statements for the year ended 31 August 2016.

1.1 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and subsidiaries controlled by the Company drawn up to 28 February 2017.

1.2 Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that are currently exercisable. The acquisition date is the date on which control is transferred to the acquirer. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date control ceases.

1.3 Going concern

The Board of Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, the financial statements have been prepared on a going concern basis.

1. Basis of preparation and significant accounting policies continued

1.4 Earnings per share

The Group presents basic and diluted earnings per share ('EPS') data for its ordinary shares. Basic EPS is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. For diluted EPS, the weighted average number of ordinary shares is adjusted for the dilutive effect of potential ordinary shares arising from the exercise of granted share options.

For the period reported, the Group has chosen to present an adjusted EPS (note 7) calculation with profit adjusted for non-underlying items to aid comparability and to provide a consistent measure of performance.

1.5 Non-underlying items

Non-underlying items are those items that are unusual because of their size, nature or incidence. The Directors consider that these items should be separately identified to ensure a full understanding of the Group's results.

1.6 Accounting estimates and judgements

In application of the Group's accounting policies, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

In preparing these condensed consolidated interim financial statements, the significant judgements made by the Directors in applying the Group's accounting policies and key sources of estimation uncertainty were the same as those applied to the Group's financial statements for the year ended 31 August 2016.

1.7 Foreign currencies

The individual financial statements of each subsidiary are presented in the currency of the primary economic environment in which it operates (its functional currency). Sterling is the predominant functional currency of the Group and presentation currency for the consolidated financial information.

In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency (foreign currencies) are recognised at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognised in profit or loss in the period in which they arise except for:

- Exchange differences on transactions entered into to hedge certain foreign currency risks

Notes to the Condensed Consolidated Interim Financial Statements continued

1. Basis of preparation and significant accounting policies continued

- Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal or partial disposal of the net investment.

For the purpose of presenting consolidated financial information, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the date of the transactions are used. Exchange differences arising, if any, are recognised in the income statement.

1.8 Hedge accounting

For the year ended 31 August 2016 and subsequent years, the Group has adopted hedge accounting for qualifying transactions. Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges), hedges of highly probable forecast transactions or hedges of foreign currency risk of firm commitments (cash flow hedges), or hedges of net investments in foreign operations.

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in the hedging reserve. Any ineffective portion of the hedge is recognised immediately in the income statement.

For cash flow hedges, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss.

When a hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a financial liability.

2. Revenue

An analysis of the Group's revenue is as follows:

	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Continuing operations			
USA	13,246	9,069	21,382
Europe, Middle East and Africa	12,958	12,064	22,582
Rest of World	5,816	4,747	10,337
Consolidated revenue	32,020	25,880	54,301

3. Operating segments

Products and services from which reportable segments derive their revenues

Information reported to the Group's Chief Executive Officer (who has been determined to be the Group's Chief Operating Decision Maker) for the purposes of resource allocation and assessment of segment performance is focused on the main product groups which the Group sells. The Group's reportable segments under IFRS 8 are therefore as follows:

- Focusrite – Sales of Focusrite branded products
- Novation – Sales of Novation branded products
- Distribution – Distribution of third party brands, including KRK speakers, Stanton, Cerwin Vega, Cakewalk and sE Electronics

Notes to the Condensed Consolidated Interim Financial Statements *continued*

3. Operating segments *continued*

The revenue and profit generated by each of the Group's operating segments are summarised as follows:

	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Revenue from external customers			
Focusrite	20,856	16,946	37,563
Novation	9,604	7,287	13,683
Distribution	1,560	1,647	3,055
Total	32,020	25,880	54,301
Segment profit			
Focusrite	9,873	7,986	17,159
Novation	4,773	3,670	6,743
Distribution	434	557	917
	15,080	12,213	24,819
Central distribution costs and administrative expenses	(10,509)	(8,521)	(17,142)
Adjusted operating profit before non-underlying items	4,571	3,692	7,677
Non-underlying items	–	(537)	(537)
Operating profit	4,571	3,155	7,140
Finance income	52	2	325
Finance costs	(24)	(725)	(339)
Profit before tax	4,599	2,432	7,126
Tax	(552)	(292)	(870)
Profit after tax	4,047	2,140	6,256

Segment profit represents the profit earned by each segment without allocation of the share of central administration costs, including Directors' salaries, finance income and finance costs and income tax expense. This is the measure reported to the Group's Chief Executive Officer for the purpose of resource allocation and assessment of segment performance.

Central administration costs comprise principally the employment-related costs and other overheads incurred by the Group. Also included within central administration costs is the charge relating to the share option scheme of £75,000 for the six-month period to 28 February 2017 (six months to 29 February 2016: £60,000; year to 31 August 2016: £120,000).

3. Operating segments *continued*

Segment net assets and other segment information

Management does not make use of segmental data relating to net assets and other balance sheet information for the purposes of monitoring segment performance and allocating resources between segments. Accordingly, other than the analysis of the Group's non-current assets by region shown below, this information is not available for disclosure in the consolidated financial information.

The Group's non-current assets, analysed by region, were as follows:

	28 February 2017 (unaudited) £'000	29 February 2016 (unaudited) £'000	31 August 2016 (audited) £'000
Non-current assets			
USA	59	26	60
Europe, Middle East and Africa	5,998	5,141	5,602
Rest of World	687	674	705
Total non-current assets	6,744	5,841	6,367

4. Taxation

The tax charge for the six months to 28 February 2017 is based on the estimated tax rate for the full year in each jurisdiction.

5. Non-underlying items

During the six months to 28 February 2017, the Group incurred no non-underlying costs. For the period to 29 February 2016 and year ended 31 August 2016 the Group incurred one-off litigation costs relating to intellectual property and distribution contracts, totalling £0.5 million, which were charged to the income statement.

6. Dividends

The following equity dividends have been declared:

	Six months to 28 February 2017 (unaudited)	Six months to 29 February 2016 (unaudited)	Year to 31 August 2016 (audited)
Dividend per qualifying ordinary share	0.75p	0.65p	1.95p

During the period, the Company paid a final dividend in respect of the year ended 31 August 2016 of 1.3 pence per share, amounting to £721,172.

Notes to the Condensed Consolidated Interim Financial Statements continued

7. Earnings per share

Reported earnings per share

The calculation of the basic and diluted earnings per share is based on the following data:

	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Earnings			
Earnings for the purposes of basic and diluted earnings per share being net profit for the period	4,047	2,140	6,256
	Six months to 28 February 2017 number '000	Six months to 29 February 2016 number '000	Year to 31 August 2016 number '000
Number of shares			
Weighted average number of ordinary shares for the purposes of basic earnings per share calculation	55,298	52,877	53,207
Effect of dilutive potential ordinary shares:			
EMI share option scheme and unapproved share option plan	2,356	5,696	5,297
Weighted average number of ordinary shares for the purposes of diluted earnings per share calculation	57,654	58,573	58,504
Earnings per share	Pence	Pence	Pence
Basic earnings per share	7.3	4.0	11.8
Diluted earnings per share	7.0	3.7	10.7

At 28 February 2017, the total number of ordinary shares issued and fully paid was 58,075,000. This included 2,586,845 shares held by the Employee Benefit Trust ('EBT') to satisfy options vesting in future years. The operation of this Employee Benefit Trust is funded by the Group so the EBT is required to be consolidated, with the result that the weighted average number of ordinary shares for the purpose of the basic earnings per share calculation is the net of the total number of shares in issue (58,075,000) less the weighted average number of shares held by the Employee Benefit Trust (2,776,555). It should be noted that the only right relinquished by the Trustees of the Employee Benefit Trust is the right to receive dividends. In all other respects, the shares held by the Employee Benefit Trust have full voting rights.

The effect of dilutive potential ordinary share issues is calculated in accordance with IAS 33 and arises from the employee share options currently outstanding, adjusted by the profit element as a proportion of the average share price during the period.

7. Earnings per share continued

Adjusted earnings per share

	Six months to 28 February 2017 (unaudited) £'000	Six months to 29 February 2016 (unaudited) £'000	Year to 31 August 2016 (audited) £'000
Earnings			
Profit for the financial period	4,047	2,140	6,256
Non-underlying items	–	537	537
Tax on non-underlying items	–	–	(107)
Total underlying profit for adjusted earnings per share calculation	4,047	2,677	6,686
	Six months to 28 February 2017 number '000	6 months to 29 February 2016 number '000	Year to 31 August 2016 Number '000
Number of shares			
Weighted average number of ordinary shares for the purposes of basic earnings per share calculation	55,298	52,877	53,207
Effect of dilutive potential ordinary shares:			
EMI share option scheme and unapproved share option plan	2,356	5,696	5,297
Weighted average number of ordinary shares for the purposes of diluted earnings per share calculation	57,654	58,573	58,504
Earnings per share	Pence	Pence	Pence
Adjusted basic earnings per share	7.3	5.1	12.6
Adjusted diluted earnings per share	7.0	4.6	11.4

8. Financial instruments

The fair value of the Group's derivative financial instruments is calculated using the quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing model for optional derivatives. Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contract.

IFRS 13 Fair Value Measurement requires the Group's derivative financial instruments to be disclosed at fair value and categorised in three levels according to the inputs used in the calculation of their fair value.

Financial instruments carried at fair value should be measured with reference to the following levels:

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

Independent Review Report to Focusrite Plc

8. Financial instruments *continued*

The financial instruments held by the Group that are measured at fair value all related to financial assets/(liabilities) measured using a Level 2 valuation method.

The fair value of financial assets and liabilities held by the Group are:

	28 February 2017 (unaudited) £'000	29 February 2016 (unaudited) £'000	31 August 2016 (audited) £'000
Financial assets			
Cash and cash equivalents	9,391	3,952	5,606
Trade receivables	9,211	7,306	9,603
	18,602	11,258	15,209
Financial liabilities			
Designated cash flow hedge relationships			
Derivative financial liabilities designated and effective as cash flow hedging instruments	443	–	1,143
Fair value through profit and loss (FVTPL)			
Forward exchange contracts	–	562	–
Amortised cost			
Trade payables	3,468	5,307	6,265
	3,911	5,869	7,408

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly report for the six months ended 28 February 2017, which comprises the condensed consolidated statement of profit and loss and other comprehensive income, condensed consolidated statement of financial position, condensed consolidated statement of changes in equity, condensed consolidated statement of cash flow and the related explanatory notes. We have read the other information contained in the half-yearly report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with the terms of our engagement. Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this 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 for our review work, for this report or for the conclusions we have reached.

Directors' responsibilities

The half-yearly report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the half-yearly report in accordance with the AIM rules.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the EU. The condensed set of financial statements included in this half-yearly report has been prepared in accordance with the recognition and measurement requirements of IFRSs as adopted by the EU.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly report for the six months ended 28 February 2017 is not prepared, in all material respects, in accordance with the recognition and measurement requirements of IFRSs as adopted by the EU and the AIM rules.

Peter Meehan (Senior Statutory Auditor)

for and on behalf of KPMG LLP
Chartered Accountants
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3 May 2017

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