

A black and white photograph of a large crowd of people at a stadium. A bright light beam originates from the top left corner and extends diagonally across the crowd. The crowd is dense and fills the lower two-thirds of the frame. The sky is visible at the top, with some clouds.

***BT Group plc listing particulars***

*September 2001*

Shareholders are advised to read the enclosed documents carefully. If you have any queries please contact our

*Shareholder Helpline on  
Freephone 0808 100 4141*

(or + 44 20 7864 9074 if you are calling from outside the UK).

**This helpline is available from:**

**8.30 a.m. to 8.30 p.m. Monday to Friday and**

**10.00 a.m. to 4.30 p.m. Saturdays, Sundays and UK public holidays.**

For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Proposals or to provide financial advice.

The Directors, whose names appear on page 8 of this document, accept responsibility for the information contained in this document. To the best of the knowledge and belief of the Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

Application has been made to the UK Listing Authority for the BT Group Shares to be admitted to the Official List and to the London Stock Exchange for such BT Group Shares to be admitted to trading on the London Stock Exchange, which together, under the Listing Rules of the UK Listing Authority, will constitute official listing on a stock exchange. Subject to the passing of the Demerger Resolution, it is expected that admission of the BT Group Shares will become effective and that dealings for normal settlement will commence at 8.00 a.m. on 19 November 2001. A copy of this document, which comprises listing particulars relating to BT Group which has been prepared in accordance with the Listing Rules made under section 142 of the Financial Services Act 1986, has been delivered to the Registrar of Companies in England and Wales for registration as required by section 149 of that Act.

No BT Group Shares have been marketed to, nor are any available for purchase in whole or in part by, the public in the United Kingdom or elsewhere in connection with the admission to the Official List. This document does not constitute an offer or invitation to any person to subscribe for or purchase any securities in BT Group plc or in any other entity.

## **BT Group plc**

(Incorporated and registered in England and Wales under the Companies Act 1985, as amended, registered number 4190816)

# ***Introduction of up to 8,700,000,000 ordinary shares of 115 pence each to the Official List***

*Sponsored by  
**Cazenove & Co. Ltd***

This document has been prepared in connection with the Demerger of mmO<sub>2</sub> from BT and, unless the context otherwise requires, assumes that the Demerger has become effective.

Cazenove & Co. Ltd, which is regulated in the United Kingdom by the Securities and Futures Authority, is acting exclusively for BT Group plc and no one else in connection with the listing of the BT Group Shares and will not be responsible to anyone other than BT Group plc for providing the protections afforded to its customers or for providing advice in connection with the listing of the BT Group Shares or the contents of this document.

The date of this document is 18 September 2001.

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SHAREHOLDER HELPLINE TELEPHONE NUMBER: **Freefone 0808 100 4141** (+44 20 7864 9074 if you are calling from outside the UK) (Monday to Friday, 8.30 a.m. to 8.30 p.m.; Saturdays, Sundays and UK public holidays, 10.00 a.m. to 4.30 p.m.)

*Note:*  
For legal reasons, the Shareholder Helpline will only be able to provide information contained in this document (other than information relating to BT's and BT Group's register of members) and will be unable to give advice on the merits of the Proposals or to provide financial advice.

## Expected timetable of principal events

BT Group Shares will be issued to BT Shareholders in connection with the Demerger. Completion of the Demerger is subject to a number of conditions, including approval of the Demerger by BT Shareholders at the Extraordinary General Meeting, which is scheduled to take place on 23 October 2001. The following is the expected timetable of the principal events connected with the Demerger:

	<b>2001</b>
EGM and Court Meeting of BT . . . . .	23 October
BT interim results for the six months ended 30 September 2001 published <sup>(1)</sup> . . . . .	8 November
Court hearing of the petition to sanction the Scheme . . . . .	14 November
Court hearing of the petition to confirm the reduction of capital of BT provided for under the Scheme . . . . .	15 November
Last day of dealings in BT Shares on the London Stock Exchange . . . . .	16 November
Scheme Record Time . . . . .	5.00 p.m. on 16 November
Scheme Effective Time . . . . .	5.30 p.m. on 16 November
Demerger Record Time . . . . .	6.00 a.m. on 19 November
Demerger Effective Time . . . . .	8.00 a.m. on 19 November
Dealing in BT Group Shares commences on the London Stock Exchange . . . . .	8.00 a.m. on 19 November
Crediting of BT Group Shares to CREST accounts . . . . .	19 November
Court Hearing of the petition to confirm the BT Group Reduction of Capital . . . . .	20 November
BT Group Reduction of Capital becomes effective . . . . .	21 November
Despatch of share certificates relating to BT Group Shares (other than in respect of shares held in CREST). . . . .	by 30 November

### Note

- <sup>(1)</sup> In the event that the publication of the BT interim results for the six months ended 30 September 2001 gives rise to a requirement for the Company to publish supplementary listing particulars, these will be available for collection on request from the Company, BT Centre, 81 Newgate Street, London EC1A 7AJ. Any change to the publication date of the BT interim results will be notified by an announcement to the Regulatory News Service of the London Stock Exchange.

All references to time in this document are to London time unless otherwise stated.

The times and dates given are based on BT Group's current expectations and may be subject to change.

**An expected timetable of principal events for holders of BT ADSs is set out in paragraph 5 of Part 2 of this document.**

Information for holders of BT ADSs or BT Shareholders who have registered addresses outside the UK or who are citizens or residents of countries other than the UK appears in paragraphs 4 and 5 of Part 2 and Part 6 of this document.

### **Cautionary statement regarding forward-looking statements**

This document contains certain statements that are forward-looking with respect to (i) the benefits and advantages of BT's restructuring and, in particular, the Demerger and the creation of two new holding companies; (ii) BT Group's strategy and its ability to achieve it; (iii) growth opportunities available in the communications industry and BT Group's positioning to take advantage of such opportunities; (iv) the strategies of each of BT Group's businesses; (v) the expansion plans of each of BT Group's businesses and plans to launch new products and services; (vi) BT Group's capital expenditure plans; (vii) BT Group's cost savings targets; (viii) BT Retail's turnover and EBITDA targets; (ix) BT Wholesale's capital expenditure, free cash flow and external turnover targets; (x) BT Ignite's EBITDA, capital expenditure and turnover targets; (xi) the Company's expectations regarding dividend payments; (xii) BT Group's plans regarding Concert; (xiii) BT Group's debt reduction plans; (xiv) the impact of regulation on current and future operations; (xv) the completion of the Group's property transaction; and (xvi) those statements preceded by, followed by, or that include the words "believes", "expects", "anticipates" or similar expressions. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that may occur in the future. There are a number of factors that could cause actual events and developments to differ materially from those expressed or implied by such forward-looking statements. These factors include, but are not limited to: (i) BT Group's ability to realise the benefits expected to be derived from its restructuring and, in particular, the Demerger and the creation of two new holding companies; (ii) material adverse changes in economic conditions in the markets served by BT Group's businesses; (iii) future regulatory actions and conditions in BT Group's businesses operating areas, including competition from others in the United Kingdom and other international communications markets; (iv) technological innovations, including the cost of developing new products and the need to increase expenditures for improving the quality of service; (v) the anticipated benefits and advantages of new technologies not being realised; (vi) developments in the convergence of technologies; (vii) prolonged adverse weather conditions resulting in a material increase in overtime, staff or other costs; (viii) the timing of entry and profitability of BT Group's businesses in certain communication markets; (ix) significant changes in market shares for BT Group's businesses, principal products and services; (x) fluctuations in foreign currency exchange rates and interest rates; (xi) general financial market conditions affecting BT Group's ability to succeed with its restructuring; (xii) BT Group's ability to deliver its plans for Concert; (xiii) BT Group's ability to benefit from the growth of and capitalise on opportunities available in the communications industry; (xiv) BT Group's ability to reduce its debts; and (xv) BT Group's ability to complete the property transaction. Certain of these factors are discussed in more detail elsewhere in this document including, without limitation, in Part 7: Factors affecting the business.

# Definitions

*The following definitions apply throughout this document, except where the context requires otherwise:*

“Admission and Disclosure Standards”	the requirements contained in the publication “Admission and Disclosure Standards” dated May 2001 containing, among other things, the admission requirements to be observed by companies seeking admission to trading on the London Stock Exchange’s market for listed securities
“Admission”, “introduction” or “listing”	admission of the BT Group Shares to (i) the Official List and (ii) trading on the London Stock Exchange’s market for listed securities becoming effective in accordance with, respectively, the Listing Rules and the Admission and Disclosure Standards
“ADR”	an American depositary receipt
“ADS”	an American depositary share
“ADS Depositary”	Morgan Guaranty Trust Company of New York in its capacity as (i) the BT ADS Depositary under the BT ADS Deposit Agreement, (ii) the BT Group ADS Depositary under the BT Group ADS Deposit Agreement or (iii) the mmO <sub>2</sub> ADS Depositary under the mmO <sub>2</sub> ADS Deposit Agreement as the context requires
“ADSL”	asymmetric digital subscriber line
“AT&T”	AT&T Corp.
“Board” or “Directors”	the directors and proposed directors of the Company, whose names are set out on page 8 of this document
“BT”	BT plc or, where the context requires, BT plc and its subsidiary undertakings
“BT ADS”	an ADS, representing 10 BT Shares, issued by the ADS Depositary in accordance with the BT ADS Deposit Agreement
“BT ADS Deposit Agreement”	the deposit agreement dated 16 November 1984 and amended and restated as of 21 November 1991 and as further amended and restated as of 10 May 2001 between BT, the ADS Depositary and holders from time to time of the ADSs issued under it
“BT Affinitis”	BT Group’s infrastructure services business
“BT Cellnet”	BT Cellnet Limited, a company registered in England and Wales with registered number 1743099
“BT Group”	BT and its subsidiary undertakings other than the mmO <sub>2</sub> Group before the Demerger Effective Time, and BT Group plc and its subsidiary undertakings following the Demerger Effective Time
“BT Group ADR”	an ADR evidencing BT Group ADSs
“BT Group ADS”	an ADS, representing 10 BT Group Shares, issued by the ADS Depositary in accordance with the BT Group ADS Deposit Agreement
“BT Group ADS Deposit Agreement”	the deposit agreement expected to be dated 16 November 2001 between the Company, the ADS Depositary and holders from time to time of BT Group ADSs issued under it
“BT Group Articles”	the articles of association of the Company
“BT Group Investments”	BT Group Investments Limited, incorporated and registered in England and Wales with registered number 4278695 which it is proposed will become the intermediate holding company of BT as part of the restructuring expected to take place after the Scheme Effective Time and before the Demerger Effective Time
“BT Group Reduction of Capital”	the proposed reduction of capital of the Company under section 135 of the Companies Act as described in Part 2 of this document
“BT Group Share Schemes”	the BT Group Incentive Share Plan, the BT Group Retention Share Plan, the BT Group Deferred Bonus Plan, the BT Group Employee Share Ownership Scheme, the BT Group Employee Share Investment Plan, the BT Group Employee Stock Purchase Plan, the BT Group Global Share Option Plan, the BT Group Employee Sharesave Scheme, the BT Group International Employee Sharesave Scheme and the BT Group Legacy Option Plan
“BT Group Shareholders”	holders of BT Group Shares
“BT Group Shares”	ordinary shares of 115 pence each (or the lower nominal amount resulting from the BT Group Reduction of Capital) in the capital of the Company

“BT Ignite”	BT Group’s international, datacentric solutions and broadband IP business
“BT Option Schemes”	the BT Share Schemes, other than the BT Incentive Share Plan, the BT Retention Share Plan, the BT Deferred Bonus Plan, the BT Executive Share Plan, the BT Employee Share Ownership Scheme and the BT Employee Stock Purchase Plan
“BT plc”	British Telecommunications public limited company, incorporated and registered in England and Wales under the Companies Acts 1948 to 1981 with registered number 1800000
“BT Retail”	BT Group’s communications service provider to the residential and business markets in the UK
“BT Shareholders”	holders of BT Shares
“BT Shares”	ordinary shares with a nominal value of 25 pence each in the share capital of BT
“BT Share Schemes”	the BT Incentive Share Plan, the BT Retention Share Plan, the BT Deferred Bonus Plan, the BT Executive Share Plan, the BT Employee Share Ownership Scheme, the BT Employee Stock Purchase Plan, the BT Global Share Option Plan, the BT Employee Sharesave Scheme 1994, the BT International Employee Sharesave Scheme, the BT Share Option Scheme, the BT Worldwide Share Option Scheme and the BT US Stock Option Plan
“BT Wholesale”	BT Group’s provider of network services within the UK to communications companies, network operators and service providers
“BTexact Technologies”	BT Group’s engineering and technology research and development business
“BTopenworld”	BT Group’s mass-market ISPs and internet related activities, serving consumers and SMEs in the UK
“business day”	a day (excluding Saturdays and Sundays or public holidays in England and Wales) on which banks generally are open for business in the City of London for the transaction of normal banking business
“Cazenove”	Cazenove & Co. Ltd
“Cegetel”	Cegetel SA
“certificated” or “in certificated form”	where a share or other security is not in uncertificated form
“Circular”	the circular sent to BT Shareholders dated 18 September 2001 which contains details of the Scheme, the Demerger and related proposals
“Companies Act”	the Companies Act 1985, as amended
“Company”	BT Group plc, incorporated and registered in England and Wales under the Companies Act with registered number 4190816
“Concert”	the global communications joint venture owned equally by BT and AT&T
“Court”	the High Court of Justice in England and Wales
“Court Meeting”	the meeting of holders of BT Shares convened by order of the court under Section 425 of the Companies Act, notice of which is set out in the Circular, to consider the Scheme, and any adjournment of that meeting
“CREST”	the system for the paperless settlement of trades in securities and the holding of uncertificated securities operated by CRESTCo in accordance with the Regulations
“CRESTCo”	CRESTCo Limited, the operator of CREST
“Demerger”	the proposed demerger of the mmO <sub>2</sub> business from BT, details of which are set out in the Circular and Part 2 of this document
“Demerger Effective Date”	the date on which the Demerger becomes effective, expected to be Monday 19 November 2001
“Demerger Effective Time”	the time at which the Demerger becomes effective, expected to be 8.00 a.m. on Monday 19 November 2001
“Demerger Record Time”	6.00 a.m. on the Demerger Effective Date
“Demerger Resolution”	the ordinary resolution proposing the Demerger to be put to the EGM
“DSL”	digital subscriber line

## Definitions

“DTC”	the Depository Trust Company
“EBITDA”	earnings before interest, tax, depreciation and amortisation
“EU”	the European Union
“Extraordinary General Meeting” or “EGM”	the extraordinary general meeting of BT, notice of which is set out at the end of the Circular, and any adjournment of that meeting
“financial year”	the year ended 31 March each year (e.g. the 2001 financial year refers to the year ended 31 March 2001)
“GPRS”	general packet radio service, a mobile data technology with advantages over existing circuit switched data services
“Great Britain”	England, Scotland and Wales
“GSM”	the global system for mobile communications. Originally defined as a pan-European standard for digital cellular telephone networks to support roaming, it is now one of the world’s main digital mobile standards. GSM can be implemented in 900 MHz, 1800 MHz or 1900 MHz frequency bands
“Hong Kong”	the Hong Kong Special Administrative Region of the People’s Republic of China
“IP”	internet protocol
“IPO”	initial public offering
“ISAs”	individual savings accounts
“ISP”	internet service provider
“Listing Rules”	the rules and regulations made by the UK Listing Authority under Part IV of the Financial Services Act 1986 as amended from time to time
“London Stock Exchange”	London Stock Exchange plc
“mmO <sub>2</sub> ” or “mmO <sub>2</sub> business”	the business of the mmO <sub>2</sub> Group, including controlled wireless assets in Europe, together with Genie and Manx Telecom
“mmO <sub>2</sub> ADR”	an ADR evidencing mmO <sub>2</sub> ADSs
“mmO <sub>2</sub> ADS”	an ADS representing 10 mmO <sub>2</sub> Shares, issued by the ADS Depository in accordance with the provisions of the mmO <sub>2</sub> ADS Deposit Agreement
“mmO <sub>2</sub> ADS Deposit Agreement”	the deposit agreement expected to be dated 16 November 2001 between mmO <sub>2</sub> plc, the ADS Depository and holders from time to time of mmO <sub>2</sub> ADSs issued under it
“mmO <sub>2</sub> Group”	mmO <sub>2</sub> plc and its subsidiary undertakings
“mmO <sub>2</sub> plc”	mmO <sub>2</sub> plc, incorporated and registered in England and Wales with registered number 4190833, which will be the holding company of the mmO <sub>2</sub> Group
“mmO <sub>2</sub> plc Shareholders”	holders of mmO <sub>2</sub> Shares
“mmO <sub>2</sub> Shares”	ordinary shares of 0.1 pence each in the capital of mmO <sub>2</sub> plc
“O <sub>2</sub> Limited”	O <sub>2</sub> Limited, incorporated and registered in England and Wales with registered number 2604354, formerly BT Wireless Limited
“Official List”	the Official List of the UK Listing Authority
“Of tel”	the Office of Telecommunications
“Optionholders”	holders of options to acquire ordinary shares under the BT Option Schemes
“Overseas Shareholders”	BT Group Shareholders with registered addresses in, or who are citizens, residents or nationals of, jurisdictions outside the UK
“PEPs”	personal equity plans
“Proposals”	the recommended proposals for the demerger of mmO <sub>2</sub> from BT, the creation of the two new holding companies and the BT Group Reduction of Capital as described in the Circular
“Reduction Order”	the Order of the Court confirming under section 137 of the Companies Act the reduction of the share capital of BT provided for by Clause 2 of the Scheme
“Regulations”	the Uncertificated Securities Regulations 1995 (SI 1995 No. 95/3272), as amended
“Rights Issue”	the 3 for 10 rights issue of 1,975,580,052 BT shares which closed on 15 June 2001



<b>“Scheme”</b>	the scheme of arrangement under section 425 of the Companies Act between BT and holders of BT Shares, details of which are set out in Part 9 of the Circular in its original form or with or subject to any modification, addition or condition approved or imposed by the Court
<b>“Scheme Effective Time”</b>	the time at which an office copy of the Reduction Order is registered by the Registrar of Companies (which, subject to the conditions applying to the Scheme, including the sanction of the Court, is expected to be at or around 5.30 p.m. on Friday 16 November 2001)
<b>“Scheme Record Time”</b>	if the date on which an office copy of the Reduction Order is registered by the Registrar of Companies is a Friday (expected to be Friday 16 November 2001), 5.00 p.m. on that date or otherwise 5.00 p.m. on the business day last preceding the date on which an office copy of the Reduction Order is registered by the Registrar of Companies
<b>“SEC”</b>	the US Securities and Exchange Commission
<b>“Securities Act”</b>	the US Securities Act of 1933, as amended
<b>“Securities Exchange Act”</b>	the US Securities Exchange Act of 1984, as amended
<b>“Shareholder Helpline”</b>	the helpline set up to advise BT Shareholders, BT Group Shareholders and other participants in the Scheme about how to complete the Forms of Proxy and to answer questions about the Proposals
<b>“SMEs”</b>	small and medium-sized enterprises
<b>“UK” or “United Kingdom”</b>	the United Kingdom of Great Britain and Northern Ireland
<b>“UK GAAP”</b>	accounting principles generally accepted in the United Kingdom
<b>“UK Listing Authority”</b>	the Financial Services Authority in its capacity as the competent authority for the purposes of Part IV of the Financial Services Act 1986 and in the exercise of its functions in respect of the admission to the Official List otherwise than in accordance with Part IV of the Financial Services Act 1986
<b>“UMTS” or “UMTS Network”</b>	universal mobile telecommunications system network – a third-generation wireless communications network
<b>“uncertificated” or “in uncertificated form”</b>	recorded on the relevant register of the share or security concerned as being held in uncertificated form in CREST, and title to which, by virtue of the Regulations, may be transferred by means of CREST
<b>“US” or “United States”</b>	the United States of America, its territories and possessions
<b>“US Holders”</b>	BT Group Shareholders with US registered addresses, unless the context requires otherwise
<b>“Viag Interkom”</b>	Viag Interkom GmbH & Co
<b>“Voting Record Time”</b>	in relation to both the Court Meeting and the EGM, 6.00 p.m. on 21 October 2001 or, if either the Court Meeting or EGM is adjourned, 48 hours before the time fixed for the adjourned meeting
<b>“Yell”</b>	the international directories and e-commerce business which BT sold for approximately £2 billion on 25 June 2001

# Directors, Company Secretary and advisers

## Directors of BT Group

Sir Christopher Bland *Chairman*

Sir Peter Bonfield, CBE *Chief Executive*

Philip Hampton *Group Finance Director*

Sir Anthony Greener\* *Non-Executive Deputy Chairman*

Helen Alexander\* *Non-Executive Director*

Maarten van den Bergh\* *Non-Executive Director*

Louis Hughes\* *Non-Executive Director*

Neville Isdell\* *Non-Executive Director*

June de Moller\* *Non-Executive Director*

Sir John Weston\* *Non-Executive Director*

all of BT Centre, 81 Newgate Street, London EC1A 7AJ.

\*to join the Board after the Demerger Effective Time.

## Company Secretary

Colin Green

BT Centre

81 Newgate Street

London EC1A 7AJ

## Registered and Head Office

BT Centre

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London EC1A 7AJ

## Sponsor, Financial Adviser and Joint Broker

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London EC2R 7AN

## Joint Broker

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London EC1A 1HQ

## Legal Advisers to the Company on English Law

Anne Fletcher

Group Legal Services

BT Centre

81 Newgate Street

London EC1A 7AJ

Linklaters

One Silk Street

London EC2Y 8HQ

## Legal Advisers to the Company on US Law

Shearman & Sterling

Broadgate West

9 Appold Street

London EC2A 2AP

## Auditors and Reporting Accountants

PricewaterhouseCoopers

1 Embankment Place

London WC2N 6RH

## Registrars

Lloyds TSB Registrars

The Causeway

Worthing

West Sussex BN99 6DA

# Key information

The following information should be read in conjunction with the full text of this document from which it is derived. BT Group Shareholders should read the whole document and not solely rely on the key information set out below.

## Business summary

The Company is the holding company for one of Europe's leading telecommunications groups, offering voice, broadband, data and internet services across a number of lines of business. BT Group comprises the following businesses:

### BT Retail

BT Retail is the UK's largest communications service provider and the prime UK channel to market for BT Group's other businesses.

### BTopenworld

BTopenworld brings together BT Group's mass-market ISPs and internet related activities, serving consumers and SMEs in the UK.

### BT Wholesale

BT Wholesale is the provider of network services and solutions to communications companies, network operators and service providers, including BT Retail, BT Ignite and, continuing after the Demerger, mmO<sub>2</sub>.

### BT Ignite

BT Ignite is an international, datacentric solutions and broadband IP business focused on European corporate and wholesale markets.

### Concert

Concert is BT Group's global joint venture with AT&T, launched in January 2000. It is a leading communications provider for multinational business customers, international carriers and ISPs worldwide.

### BTexact Technologies

BTexact Technologies is an internationally-renowned engineering and technology research and development business.

### BT Affinitis

BT Affinitis provides and manages the following business infrastructure services for BT Group: property, facilities, computing, fleet, procurement and logistics.

### Other businesses

BT Group also holds stakes in certain other companies, including a 26 per cent. stake in Cegetel, a leading French telecommunications company.

## Strategy

The Company is the holding company of a balanced portfolio of businesses focused on the provision of voice and data services in the UK and elsewhere in Europe. Its aim is to create value based on service excellence, its brand leadership, its large scale networks and its existing customer base.

BT Group intends to build upon its reputation in various parts of the communications market by expanding into areas of higher value broadband and internet services and products.

## Regulation

Most of BT Group's fixed-network activities in the United Kingdom are subject to regulatory controls. The controls regulate, among other things, the prices BT Group may charge for its services and the extent to which it has to provide services to its competitors. In recent years, the effect of these controls has been to cause BT Group to reduce its prices. In developing its business internationally, BT Group will be required to take account of the regulatory regimes in the countries in which it operates or wishes to operate.

## Summary financial information

The table below, the contents of which have been extracted without material adjustment from the comparative table on BT in Part 5 of this document, summarises the trading record of the continuing activities of BT, which comprises BT Group, for the three years ended 31 March 2001:

BT Group	Year ended 31 March		
	1999 £m	2000 £m	2001 £m
Group turnover	15,197	16,125	17,130
Total operating profit	3,241	3,169	2,491
Profit on ordinary activities before taxation	4,087	2,964	2,076
Earnings per ordinary BT Group Share — basic <sup>(a)</sup>	40.4p	29.7p	21.6p
Earnings per ordinary BT Group Share — diluted <sup>(a)</sup>	39.5p	29.0p	21.3p

(a) restated for the dilutive effect of the Rights Issue but before restatement for the adoption of FRS 19 — deferred taxation on 1 April 2001.

## Current trading and prospects

BT Group's operating performance since 31 March 2001, the end of the last financial year, has been satisfactory, although profits have been impacted by increased depreciation, amortisation and interest charges.

Considerable progress has been made in reducing net debt, primarily by means of the Rights Issue and disposals of non-core businesses, and this will benefit future financing costs. Prospects for the remainder of the financial year continue to be satisfactory.

## **Key information**

### **Recent developments**

BT is continuing discussions with AT&T concerning the future of the Concert joint venture. Options currently being considered include unwinding the Concert joint venture. Other strategic alternatives to Concert are still being discussed, including continuation of the venture in a modified form. In the event that an unwinding of the Concert joint venture is agreed, and depending on the way that it is implemented, the financial effects on the BT Group are likely to include cash and non-cash restructuring costs which could be substantial. These discussions are dealt with in more detail in paragraph 4 of Part 1 of this document.

In addition, BT expects to take an impairment charge against certain of its other investments, including AT&T Canada, in its half year results to 30 September 2001, totalling approximately £500 million. BT Group's investment in AT&T Canada is discussed in more detail in paragraph 4 of Part 1 of this document.

BT expects to complete a sale and leaseback property transaction by 31 December 2001, under which it expects to receive proceeds of approximately £2.3 billion. The Board now expects to reduce net debt to between £15 billion and £17 billion at 31 March 2002 on the assumption that this property sale and leaseback transaction has been completed.

### **Dividend policy**

BT did not pay a final dividend for the year ended 31 March 2001 and its board has decided that there will be no interim dividend for the year ending 31 March 2002. The Board expects to recommend a final dividend for BT Group in respect of the year ending 31 March 2002 and resume regular dividend payments thereafter. However, the level of dividends which the Company expects to pay is likely to be substantially lower than that paid by BT previously.

### **Continuing relationship between the Company and mmO<sub>2</sub> plc**

Prior to the Demerger, mmO<sub>2</sub> operates largely through subsidiaries, as a division of BT. However some of its internal organisation and parts of its internal procedures are integrated with those of BT. Immediately following the Demerger, neither the Company nor mmO<sub>2</sub> plc will have any shareholding in the other and BT Group and mmO<sub>2</sub> Group will operate as separate businesses.

The Company, BT, mmO<sub>2</sub> plc and members of the mmO<sub>2</sub> Group have entered into several agreements for the purpose of giving effect to the Demerger and defining the continuing relationship between BT Group and mmO<sub>2</sub> Group, which have been concluded as a result of arm's length negotiations and are summarised in paragraph 3 of Part 2 of this document.

# *Part 1: Information on BT Group*

## **1. Background**

In May 2001, the board of BT announced a number of structural changes to provide commercial and financial flexibility to BT. These included the Rights Issue, the sale of Yell and the disposal of non-core businesses and assets. In addition, the board of BT announced the positioning of BT Group as a focused European network and retail business and the proposed demerger of mmO<sub>2</sub>.

The Rights Issue raised approximately £5.9 billion, net of expenses. It provided BT with the financial flexibility to continue with its structural change and contributed to the reduction of BT's debt. Since that time, BT has disposed of a number of businesses and assets and has reduced the level of net debt within BT from £27.9 billion at 31 March 2001 to £17.5 billion as at 30 June 2001.

The Demerger will create two listed companies, BT Group plc and mmO<sub>2</sub> plc. Further information relating to the Demerger and related proposals is set out in Part 2.

## **2. Nature of financial information**

All financial information in this Part 1 is extracted from the financial information set out in Part 5 of this document. It should be read in the light of the full text of this document from which it is derived and key or summarised information should not solely be relied upon.

## **3. BT Group strategy**

BT Group plc is the holding company of a balanced portfolio of businesses focused on the provision of voice and data services in the UK and elsewhere in Europe. Its aim is to create value based on service excellence, its brand leadership, its large-scale networks and its existing customer base. It will also develop and market new higher value broadband and internet products and services. BT Group comprises principally four separately managed lines of business, BT Retail, BTopenworld, BT Wholesale and BT Ignite, together with its Concert joint venture. BT Retail and BT Wholesale are well established, cash generative businesses with market-leading positions in the UK, while BT Ignite and BTopenworld are rapidly developing businesses, active in the markets for internet and data services, solutions and broadband.

The current organisation of BT Group reflects the process of structural change upon which BT embarked in 2000. BT Group has moved away from a geographically-based organisational structure to one based around separate lines of business. It has been creating commercial boundaries and establishing separate balance sheets for each of the lines of business. BT Group's goal is to improve operational focus and management accountability of the individual operations, thereby enhancing transparency and the ability of the BT Group to serve the needs of its customers more effectively.

Building on the establishment of separate business units, the Directors are currently considering whether to seek the grant of separate telecommunications licences for certain operations. Any review may or may not lead towards further separation of these businesses from each other. In the current market climate, the Board remains confident, for the time being, that value can be generated for shareholders without the full or partial listing of any line of business.

In the opinion of the Directors, BT Group's relationship with its customer base represents a major strength and it is the Directors' intention to broaden the range of services offered by the BT Group in order to reinforce this relationship. For example, the Company intends to build upon BT's reputation in various parts of the communications market by expanding into areas of higher value broadband and internet services and products. In particular, the Company continues to identify and evaluate new areas, both geographic and product, where the current burden of regulation is less severe.

BT Group will have a significant concentration of revenue and profit within the UK communications market. It is the longer term aim of the directors of BT Group to increase the proportion of revenue from operations outside the UK. It is intended that this will be achieved through focused investment in support of BT Group's global customers, primarily in Europe, via BT's high quality solutions sales and support operations.

Currently, Concert provides international connectivity for the BT Group's wider operations, as well as managing the sale of services to large multinational customers. BT and AT&T, the joint owners of Concert, are currently in discussions concerning the future of the Concert joint venture. Further details can be found under "Discussions with AT&T regarding Concert" in paragraph 4 of this Part 1.

Through a focus on projects offering higher and more immediate financial returns, BT Group's aim is to reduce capital expenditure from approximately £3.9 billion in the year ended 31 March 2001 to £3.4 billion in the year ending 31 March 2002, with medium-term capital expenditure expectations of approximately £3.5 billion per annum. Furthermore, productivity improvements and cost

## **Part 1: Information on BT Group**

savings will also be sought and initiatives to reduce costs totalling approximately £575 million have been identified for the year ending 31 March 2002. The Board now expects to reduce net debt to between £15 billion and £17 billion for BT Group at 31 March 2002 on the assumption that BT's property sale and leaseback transaction, which is expected to raise approximately £2.3 billion, has been completed.

### ***Continuing relationship between the Company and mmO<sub>2</sub> plc***

Immediately following the Demerger, neither the Company nor mmO<sub>2</sub> plc will have any shareholding in the other and BT Group and mmO<sub>2</sub> Group will operate as separate businesses. The Demerger and the agreements governing the continuing relationship between BT Group and mmO<sub>2</sub> are described in further detail in Part 2 of this document.

BT Group and mmO<sub>2</sub> will deal with each other on an arm's length basis. The UK business relationship will initially be governed under the aegis of a framework agreement.

An anticipated result of the Demerger is the increase in freedom for both the Company and mmO<sub>2</sub> plc to devise and employ strategies to generate additional benefit to customers and to shareholders. BT has agreed that, until 31 March 2003, it will not offer mobile products and services to the consumer market in the UK solely under the BT brand. It may, however, offer mobile products and services under the BT brand if co-branded with the brands of other mobile operators, and may offer fixed and mobile bundled products under the BT brand. Furthermore BT and BT Cellnet have agreed that, for a period of three years from the Demerger, BT will exclusively promote the mobile products and services of BT Cellnet to the business market in the UK. The BT Group has no current intention of obtaining licences to enter the UMTS or GSM wireless markets in territories in which mmO<sub>2</sub> currently holds UMTS or GSM licences.

BT has entered into an agreement that provides for certain members of the mmO<sub>2</sub> Group, following the Demerger, to use certain trademarks and brands owned by the BT Group on a transitional basis including, for example, the BT name and the half piper logo, to the extent that they used such name and logo immediately before the Demerger (except in respect of fixed line telephony goods and services and all other hardware and telecommunications equipment, and certain internet related services).

The administration and services arrangements are on the whole designed to ensure that each party will bear an equitable share of the costs of the relevant services provided until they have established their own separate arrangements.

Further details on the agreements governing the continuing relationship between the Company and mmO<sub>2</sub> plc and the separation of their businesses, assets and liabilities including guarantees are set out in Part 2 of this document.

## **4. Activities and strategies of BT Group's businesses**

BT Group principally comprises BT Retail, BTopenworld, BT Wholesale and BT Ignite, together with BTextact Technologies, BT Affinitis and the Concert joint venture.

### ***BT Retail***

BT Retail is the UK's largest communications service provider, by market share, to the residential and business markets. It is the prime channel to market for the other businesses in the BT Group and it trades under the BT label, which is one of the UK's leading brands.

BT Retail is implementing a customer-focused strategy with the objective of being recognised as the communications industry's customer service "champion". Its objectives are to improve quality of delivery and customer satisfaction while, at the same time, reducing costs by improving efficiency and productivity. Early results, for the period between November 2000 and June 2001, include a 60 per cent. drop in complaints handled by Oftel and a 20 per cent. fall in repeat faults.

BT Retail's aim is to enable its business and residential customers to communicate with the world around them, using an extensive product and service portfolio covering voice, data, internet and multimedia, as well as managed and packaged communications solutions.

As at 30 June 2001, BT Retail had 28.2 million customer lines (exchange line connections) equating to a UK market share of approximately 83 per cent. Some nine million of these were business lines and lines for other service providers. The remainder of the lines were for residential customers.

On average, about 100 million UK local and national calls are made every day from BT lines. The number of calls made from fixed to mobile phones continues to grow strongly, but this growth is largely offset by a decline in traditional fixed-line local, national and international call volumes caused by mobile phone substitution and intense competition from other UK operators.

### **Residential**

The Directors estimate, based on internal information, that, in the residential fixed-call market, BT Retail's share of fixed-voice call minutes over the last three quarters has remained stable at 73 per cent., having fallen from 79 per cent. in mid-1999 to 74 per cent. by mid-2000.

During the past 12 months, BT Retail has developed innovative pricing policies, including SurfTime, BT's low-cost internet access service, and BT Together. BT Retail, together with leading ISPs such as BTinternet and Freeserve who participate in BT Retail's SurfTime package, currently has around one million subscribers to its Surf packages, which account for a third of all BT's residential internet traffic. Approximately nine million customers have signed up for the BT Together range of packages and at March 2001 two-thirds of the total consumer call minutes were made by customers on fixed fee packages. BT Retail's growing competitiveness has been endorsed by independent consultants. Deloitte & Touche's report in July 2001 showed that, based on tariffs current at 1 June 2001, BT Retail's prices were up to 26 per cent. cheaper than its cable competitors, when comparing whole bills.

### **Business**

BT Retail delivers tailored information technology solutions for SMEs and larger organisations in the private and public sectors and has introduced the BT Commitment pricing package to deliver competitive prices to corporate business customers.

National Opinion Poll figures show BT Retail to be a leading supplier for internet service provision and web hosting for businesses of between five and 500 employees. Customers are being connected at a rate of 1,000 a week. In the major business sector, BT Retail is working with BT Ignite and companies such as Nortel Networks Ltd, Cisco Systems Inc and BroadVision Inc to help large organisations to develop effective multi-media communication with their customers. Overall, more than a third of BT Retail's major business revenues, for the year to 31 March 2001, came from new-wave products and services, such as internet, wireless and packaged IT solutions, and these are growing significantly year-on-year.

BT Retail's website (accessed through [www.bt.com](http://www.bt.com)) provides residential and business customers with an e-commerce channel for accessing information and services for their communication needs. Registered users had grown to 1.9 million as at 8 August 2001 and, on average, every week some 90,000 users view a bill on the site. It is the fifth largest "clicks and mortar" site in the UK and orders for more than £100 million worth of products and services were made or initiated through [www.bt.com](http://www.bt.com) during the 2001 financial year.

In a very competitive market, BT Retail's financial strategy is to maintain turnover and EBITDA margins in the medium term at 2001 levels by seeking ongoing productivity improvements, by defending and growing revenues in existing businesses, by growing the profitable distribution of products managed throughout the BT Group or by external partners and by developing new business opportunities in adjacent markets.

### ***BTopenworld***

BTopenworld brings together in a single business all of BT's mass-market ISPs and internet related activities. It serves consumers and SMEs in the UK with a range of narrowband and broadband internet access and related services.

BTopenworld aims to generate additional revenues for BT Group by providing customers with services that add value to the basic telephony service, earning subscription, advertising and e-commerce revenues. Internet services also benefit BT Group indirectly through stimulating additional network usage.

BTopenworld's aim is to inspire its customers to explore the internet as a whole, rather than to try to keep customers confined within a "walled garden" of content. BTopenworld's strategy, therefore, is to emphasise access services and revenues and to build a home page that gives customers the tools they need to explore the internet, rather than to seek to provide content that is readily available on many other sites.

BTopenworld has become one of the UK's leading internet service providers, with approximately 1.45 million active customers. This total includes over 800,000 unmetered customers (paying monthly rather than per minute fees for service), making BTopenworld one of the leaders in this sector. BTopenworld is the UK's leading retailer of DSL broadband services, with over

## **Part 1: Information on BT Group**

40,000 customers. In addition, BTOpenworld provides a number of companies (including ITV Digital and Dell) with a wholesale internet access service which they market to their customers.

### **BT Wholesale**

BT Wholesale provides network services and solutions within the UK to communication companies, network operators and service providers, including BT Retail, BT Ignite and, continuing after the Demerger, mmO<sub>2</sub>.

BT Wholesale has the largest capacity network in the UK with the greatest geographic reach and customer coverage. It has 117 million copper pair kilometres and 5.4 million kilometres of optical fibre which enable it to reach into virtually every home and business in the UK.

During the 2001 financial year, BT Wholesale continued to invest in its UK network to meet increasing demand for high quality fixed-network products and services, both narrowband and broadband. Its investment objective for the access network is to utilise electronics to provide higher bandwidth services over existing access cable infrastructure, both copper and fibre, to provide the platform for next generation products and services and to reduce costs. BT Group believes this should mitigate erosion of market share and generate attractive returns on capital. By the end of September 2001, 13 million homes, some 60 per cent. of UK households, will be in areas served by an ADSL (broadband)-enabled exchange.

BT Wholesale has approximately 8,000 exchanges, all of which are digital. By the end of August 2001, it had replaced 64 trunk exchanges with Next Generation Switches (“NGS”) which have double the capacity of the replaced exchanges. The objective is to move from a circuit-switched network to a predominantly packet-switched network over the next five years. This will give greater capacity and the flexibility to packet switch any combination of voice and data, initially using the Asynchronous Transfer Mode. BT Wholesale intends to move towards a wholly IP-based network, once carrier-class IP solutions, for example voice over IP, are commercially available.

Demand is increasing for greater transmission bandwidth, driven by the growth of IP, e-business, multimedia applications and mobile, and to support more sophisticated data and video applications. BT Wholesale has completed a 12 month project which has resulted in one of the world’s largest all new Synchronous Digital Hierarchy (“SDH”) broadband overlay networks, with points of presence in 800 sites, covering all of the main towns and cities across the UK. SDH technology is now deployed to over 2,000 nodes with a capacity of 22 terabits per second. BT Wholesale’s transmission objective is to build scaleable networks that can support volume demand for the increasing bandwidth needs and to exploit its high capacity optical bearer network to launch new wholesale market optical products.

During the 2001 financial year, BT participated in implementing and accelerating the local loop unbundling (“LLU”) programme in the UK. LLU enables other telecommunications operators to use the existing local loop (the connections between customers’ premises and the exchange) to connect directly with their customers. The roll out of LLU has been the subject of an amendment to the BT Licence, a specific EU regulation and, in the UK, agreements with Oftel. BT is in compliance with each of these.

BT Wholesale’s objective is to increase substantially its sales of one-stop solutions to communications companies. The majority of BT Wholesale’s revenues are generated from sales within BT Group, and together, BT Retail and BT Ignite currently account for some 67 per cent. of BT Wholesale’s total turnover. Just over half of its external turnover is subject to regulatory controls. BT Wholesale aims to reduce its dependence on its regulated business and grow its sales to other communication companies. Many other telecommunications operators use the BT Wholesale network to help deliver their customers’ calls. This interconnect activity has increased rapidly as competition in the fixed and mobile sector has intensified and BT Wholesale intends to extend these existing relationships.

BT Wholesale aims to build on its position as the largest network operator in the UK and on its key strengths of speed of mass deployment, innovation and one-stop, total solutions service offerings to meet the communication needs of its customers.

Its strategy is to:

- provide total customer solutions, from basic network connectivity services to fully integrated communications services;
- broaden its customer base and competitive scope;
- build and develop relationships with other parts of BT Group who act as distributors, other network operators and major communications suppliers; and
- establish a reputation for outstanding service delivery.



In the year to 31 March 2001, the business incurred capital expenditure of approximately £2.3 billion and anticipates that its future capital expenditure will be in the region of £2 billion per annum over the medium-term. BT Group plans, through tight controls on operating costs and capital expenditure, to ensure that the current level of free cashflow generated by BT Wholesale is maintained over the medium-term. BT Wholesale is aiming to grow external turnover by over 20 per cent. per annum in the short to medium-term.

### ***BT Ignite***

BT Ignite, BT Group's international, datacentric solutions and broadband IP business, delivers a range of services, including customer solutions, application service packages, web hosting, media services and data transport. In particular, BT Ignite's internet data centres provide the hardware and high-speed communications connections required by customers to run their websites and their online business applications, allowing these customers to focus on their core business and meet growing requirements for e-commerce.

BT Ignite has established a strong European footprint, serving business customers with 52,000 route kilometres of fibre connecting 250 cities and with 22 content hosting centres. Across Europe, BT Ignite controls its own infrastructure, but is primarily a service and marketing business using its own sales and service team of approximately 2,000 employees, in addition to over 10,000 people employed in network and IT solutions operations across the world. It sells direct to businesses in Europe and sells to businesses in the UK through BT Retail's sales force.

Building on its position as a leading business in the European services market, as measured by customer and revenue base, BT Ignite plans to continue to build its revenues from the high end of the value chain. Value-added services, complex business solutions, hosting and media distribution currently represent over 60 per cent. of BT Ignite's turnover.

BT Ignite aims to use its direct and indirect channels to add more business customers and increase revenue per customer by selling more of these higher value products and migrating customers towards tailored services, such as moving customers through hosting and applications to complete solutions. Its strategy for moving into profitability also includes increasing the throughput in its existing network infrastructure of cables and data hosting to benefit from operational gearing.

Functional responsibilities have been established across the BT Ignite business, including single network management and single product management, from which BT Ignite expects to generate synergies.

EBITDA is targeted to approach 15 to 20 per cent. of turnover over the medium-term and capital expenditure is targeted to be approximately £1.0 billion per annum, compared to £0.9 billion for the year ended 31 March 2001. The growth in turnover is targeted in excess of 15 per cent. per annum in the medium-term.

### ***Concert***

Concert is a global communications joint venture owned equally by BT and AT&T. It combines what were the trans-border assets and operations of BT and AT&T, including their international networks, all their international traffic and their international products for business customers. Concert's results have been impacted by market pricing pressures and an increase in industry capacity, while network costs have remained fairly constant. Concert has also been impacted by weakness in sales from its non-parent global distributors and its wholesale operation. Management actions to seek to improve the financial position include reductions in headcount, capital expenditure cuts and aggressive performance improvement plans.

### ***Discussions with AT&T regarding Concert***

The discussions between AT&T and BT concerning the future of the Concert joint venture are continuing. Options involving the sale or other business combinations of BT Group's business services operations, with AT&T's business services unit are no longer being considered at this time. Other strategic alternatives to Concert are still being discussed, including continuation of the venture in a modified form. Options currently being considered include unwinding the Concert joint venture and there are a number of ways in which this might be accomplished. In any such unwinding, Concert's business would be divided between AT&T and BT and be subsumed into their businesses. Continuity of supply and continued support of BT Group's existing and future customers' global communications needs and retention of the skills of key personnel are key objectives in all of the options under discussion.

In the event that an unwinding of the Concert joint venture is agreed, and depending on the way that it is implemented, the financial effects on the BT Group are likely to include cash and non-cash restructuring costs which could be substantial. Furthermore, Concert's future operating losses would be divided between AT&T and BT Group in accordance with any agreement to unwind the joint venture. In such an event, the Board of the Company expects to take steps to reduce such losses. The financial effects of any agreement cannot be quantified until an agreement has been reached. The value of Concert in BT's balance sheet as at 30 June 2001 was £1,349 million.

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There can be no assurances that agreement will be reached with AT&T regarding any of the alternatives under consideration. In the absence of any such agreement, the joint venture will continue in existence.

### ***AT&T Canada***

BT's carrying value of its effective nine per cent. interest in AT&T Canada stood at £350 million at 30 June 2001. BT considers that this investment has been impaired and it expects to take a charge against the investment in its results to 30 September 2001 representing a substantial part of its carrying value.

BT's agreement with AT&T provides for BT to contribute to AT&T's obligation to purchase up to 100 per cent. of AT&T Canada, up to a maximum cost for BT of Canadian \$1.65 billion. This would result in BT Group having a stake of up to 30 per cent. in AT&T Canada. Under the existing agreements, an unwinding of the Concert joint venture would afford BT Group the right to sell its current effective nine per cent. interest in AT&T Canada to AT&T, under a put option, and BT Group would no longer be obliged to provide further funding. AT&T has not agreed to an unwind of Concert giving rise to such provisions and there can, however, be no assurance that any such agreement will be reached.

### ***BTexact Technologies***

BT Group's commitment to research and development is fundamental to ensuring that it can continue to provide its customers with advanced information and communication services.

BTexact Technologies comprises BT Group's engineering and technology research and development activities. Its principal customers are the BT Group lines of business. BTexact Technologies also offers a portfolio of professional and consultancy services to external clients.

BTexact Technologies plans to exploit BT Group's extensive intellectual property rights where this is to the Company's commercial and strategic advantage. Brightstar, BT Group's in-house technology incubator, plays an important part in the exploitation of BT's intellectual property rights. It aims to facilitate the launch of the best hi-tech business ideas as start up businesses. Three such businesses were launched in the 2001 financial year and a number of businesses are currently in development.

Major areas of research and development work include next generation internet and fixed-access networks; advanced data services; information and network security; and software systems to support the management and integrity of networks worldwide. BT Group is also undertaking research on the future impact of advanced communications on lifestyles, education and healthcare in the connected society.

The research and development centre at Adastral Park in the UK is complemented by a wide range of partnerships with leading technology industry suppliers and universities worldwide.

### ***BT Affinitis***

BT Affinitis brings together the provision and management of the majority of the business infrastructure services that are supplied across the BT Group. Services include property and facilities, the support and operation of information systems, the management of commercial and company car fleets, and procurement and logistics services. Currently, BT Affinitis' customers are primarily the BT Group lines of business. In time it may seek to extend the provision of services externally, where practicable.

The scale and breadth of BT Affinitis offers the opportunity to generate value for BT Group, initially through cost reductions and then by generating new revenue streams.

On 9 May 2001, BT selected Telereal Group Limited ("Telereal") as preferred bidder for the acquisition of a substantial part of BT's property portfolio and the subsequent provision of accommodation services back to BT. On 12 June 2001, BT and Telereal entered into a legal agreement for the acquisition and subsequent service provision subject to conditions precedent, being primarily conditions relating to satisfactory funding and the finalisation of transactional commercial documentation. Detailed commercial and legal negotiations continue.

Telereal Group Limited is a 50:50 joint venture between Land Securities Trillium Limited (a wholly owned subsidiary of Land Securities plc) and William Pears Family Holdings Limited. BT expects to complete the sale of the property portfolio by 31 December 2001. The transaction, on completion, is expected to raise approximately £2.3 billion.

### ***Other businesses***

BT Group holds stakes in certain other companies, including a 26 per cent. stake in Cegetel, a leading French telecommunications company providing a broad range of telecommunications services, including mobile and fixed telephony, internet access, data services and transmission.

## **5. Regulation**

### **Regulation, competition and prices**

The commercial environment in the UK and in the countries in which BT Group operates or wishes to operate is increasingly competitive and dynamic. However, BT Group remains subject to extensive regulation, particularly in the UK, which can materially affect the way in which the Company carries out its business.

### **Regulation in the UK**

The regulatory structure for UK telecommunications is set out principally in the Telecommunications Act 1984, which gives regulatory authority to the Secretary of State for Trade and Industry and the Director General of Telecommunications, who heads Oftel. The Secretary of State and the Director General are required to ensure, so far as reasonably practical, that all reasonable demand for telecommunication services, including certain community services, is met and to secure the ability of licensed telecommunications operators to finance the provision of the services which they are licensed to provide. In addition, they are required, among other things, to promote the interests of consumers, purchasers and other users in the prices, variety and quality of telecommunication services and equipment, and to promote and maintain efficiency and effective competition among UK telecommunications operators.

With limited exceptions, a licensee under the Telecommunications Act 1984 is required to operate a telecommunication system in the UK. The Secretary of State is responsible for issuing licences after consulting the Director General.

The Director General may make modifications to a licence if the licensee does not object or if the amendment is deregulatory. Alternatively, proposed changes to the licence may be referred to the Competition Commission. In either case, the Telecommunications Act 1984 requires public consultation before a licence can be modified.

Licences may also be modified by legislation, including legislation implementing European Commission directives in UK law.

### **Licensing arrangements for the BT Group**

BT operates in the UK under a number of licences; the most important of which is its licence to operate its fixed-line public telecommunications network (the “Licence”). The Licence remains in force indefinitely, but the Secretary of State may revoke the Licence on 10 years’ notice. The Licence can also be revoked at any time on various grounds, including non-compliance with its terms, following notice from the Secretary of State.

The Licence contains terms and conditions designed principally to ensure the widespread provision of telecommunication services in the UK, to protect the interests of consumers and to encourage the development of effective competition in telecommunication services and network provision within the UK.

Under the Licence, BT has to fulfil reasonable requests for access to voice telephony, low-speed data and fax transmission services, and reasonable access to public call boxes throughout nearly all of the UK, including rural areas (these being the principal elements of the universal service obligation).

Under the Licence, BT must allow other licensed operators to interconnect with its telecommunications systems on cost-oriented, transparent and non-discriminatory terms.

BT must comply with a variety of fair trading obligations, such as:

- a prohibition on showing undue discrimination or unfairly favouring any part of its own business as against competitors on the basis of price terms or quality of service; and
- a prohibition on the unfair cross-subsidy of certain activities of BT.

BT must publish audited financial statements for the regulated “businesses” and “activities”, in order to support the linkage of costs with interconnect charges and with a view to providing demonstrable evidence that BT is neither behaving in a discriminatory fashion nor unfairly subsidising its activities. The regulatory businesses for which separate accounts are currently produced are access, apparatus supply, network, retail systems (split into eight “activities”), mobile, supplemental services and residual.

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The Licence includes price control formulae, the overall effect of which requires BT to reduce, or restrict the extent to which it can increase, the prices of many of its telephony services to the bulk of the residential market and also the prices for its interconnection services. In addition, the Licence contains certain specific restrictions on the terms on which BT can trade. In particular, BT is required to publish and adhere to certain prices and other terms for providing certain services.

### **Implementation of the Licensing Directive**

In September 1999, modifications to the Licence came into force to meet the harmonisation requirements of the European Community Licensing Directive (the "Directive"). The intention of the Directive was to prevent excessive or unjustified regulation through licensing of telecommunications. The modifications included the removal, as from January 2001, of restrictions that prevented BT from competing in the conveyance and provision of broadcast visual services to homes in the whole of the UK.

### **Competition**

#### ***Competition Act 1998***

In addition to telecommunications industry regulation, the Company will be subject to general competition law.

The Competition Act 1998, which came into effect in March 2000, brings the UK in line with European Community law by prohibiting anti-competitive agreements and concerted practices and the abuse of a dominant market position. In the case of telecommunications, the Director General of Telecommunications has concurrent investigatory and enforcement powers with the Director General of Fair Trading. They also have significant new investigative powers. Breach of the relevant prohibitions could lead to fines of up to 10 per cent. of turnover in the UK for each year of infringement (up to a maximum of three years) and/or result in claims for damages in the civil courts. There are powers to order a company to cease an infringing activity.

There is a new statutory independent appeals mechanism for decisions under the Competition Act 1998.

#### ***The competitive environment***

The UK telecommunications market is fully open to new entrants and is highly competitive. As a result, the UK Government and Oftel have indicated their expectation that it will be appropriate to move away from sector-specific (including licence-based) regulation to greater reliance on the Competition Act 1998.

However, as described above, Oftel currently regulates BT mainly through the provisions in the Licence. BT Group has commenced discussions with Oftel on amendments that BT Group believes should be made to the Licence to take account of the introduction of the Competition Act 1998.

Although it is some 17 years since the Telecommunications Act 1984 abolished the exclusive privilege of running telecommunications systems held by British Telecommunications, the former statutory corporation, obligations placed on BT are generally more onerous than for other licensees.

### **Pricing regulation**

#### ***Fixed-network***

The Company will be subject to price controls on its fixed-network services in the UK at two levels: retail and network. Competitors are generally not subject to price controls.

#### ***Retail price controls***

The Company will be subject to two sets of UK retail price controls, one on certain public-switched telephony call charges and exchange line rentals, and one on certain private circuits. Each price control is based on a formula calculated by reference to the UK Retail Prices Index ("RPI") and a factor, X.

For services covered by the controls, weighted average prices cannot increase in each year beginning 1 August by more than the annual change in RPI minus X. In times of low inflation, the overall effect of this control requires the company to reduce its prices.

The retail price control for public-switched telephony, applying from August 1997 to July 2001, was RPI minus 4.5. Although it is measured on services used by the lowest 80 per cent. of BT Group's residential customers classified by bill size, controlled prices must be offered to all residential customers.

In March 2001, BT accepted Oftel's proposal for a one-year extension of the current retail price controls until July 2002. Oftel indicated that it would consult again to determine whether there is sufficient competition to remove retail price controls from 1 August 2002. Oftel

began this further round of consultation on 31 July 2001 with the publication of a consultative document “Competition in the Provision of Fixed Telephony Services”. Should Oftel decide that there is likely to be insufficient competition beyond July 2002, then it would consider further price controls, introducing other regulatory measures to stimulate competition or a combination of price controls and other regulatory measures.

The price control formula and the Company’s performance against the formula are set out in the table below:

	Years commencing 1 August						2001
	1995	1996	1997	1998	1999	2000	
Price control formula (RPI-X)							
Per cent. RPI movement for the relevant period <sup>(a)</sup>	3.52	2.14	2.94	3.75	1.35	3.32	<b>1.93</b>
X in price control formula <sup>(b)</sup>	7.50	7.50	4.50	4.50	4.50	4.50	<b>4.50</b>
Per cent. required reduction in prices <sup>(c)</sup>	(1.38)	(4.92)	(1.56)	(0.73)	(3.15)	(1.09)	<b>(2.45)</b>
Per cent. reduction in prices overall	(1.82)	(4.92)	(1.56)	(0.73)	(3.24)	(1.20)	— <sup>(d)</sup>

*Notes:*

- (a) Annual increase in RPI to previous June
- (b) From 1 August 1997, the RPI formula covers the main switched telephone services provided to the lowest 80 per cent. of BT Group’s residential customers by bill size
- (c) After permitted carry forward of any unused allowance or shortfall from previous years
- (d) No price changes implemented up to 17 September 2001

BT has given an assurance that a “control” price package will be made available to business customers. The control package for small business customers provides that call charges will be no higher than the prices used for calculating adherence to the residential price control and that line rental increases will be no more than the change in RPI.

Under the price control for private circuits that applied from August 1997 to July 2001, prices for domestic analogue and low-speed digital private circuits could not be increased by more than the change in the RPI in any one year. The application of the analogue price cap has been extended until July 2005 and the low-speed digital private circuits price cap was removed from July 2001.

In addition, BT is subject to a control on its retention for calls to BT Cellnet and Vodafone mobiles. BT’s retention is defined by its retail price net of termination payments to the mobile operator. Under this control, applying from 1 April 1999 to 31 March 2002, BT’s retention for calls to BT Cellnet and Vodafone cannot increase by more than RPI minus 7 each year. In February 2001, Oftel extended this control by four months until 31 July 2002.

**Network charge control**

BT operates under interconnection agreements with most other licensed operators.

A network charge control regime, operating until 30 September 2001, gives BT the freedom to set reasonable charges based on forward-looking long-run incremental costs for its standard interconnection services.

Depending on the degree of competition for these services, charges are cap controlled (presently at RPI minus 8), safeguard cap controlled (i.e. no increases above RPI during any relevant year) or no longer subject to direct charge controls.

In March 2001, BT accepted Licence modifications that included new network charge controls for a period of four years from October 2001. The new controls fixed varying levels of “X” within the RPI minus X price-cap formula for non-competitive services of between 7.5 and 13 for each of the services within four price-cap baskets. Controls will not be applied to interconnection services determined by Oftel to be competitive. New services will not generally be subject to charge controls, but Oftel will retain the power to introduce controls if they deem them necessary. Services determined by Oftel to be prospectively competitive will be subject to safeguard caps set at RPI plus 0.

BT must publish a notification to the Director General and other licensed operators if it intends to amend existing charges or to offer new services.

**Non-UK regulation**

In developing its business internationally, BT Group must take account of the regulatory regimes in the countries in which it operates or wishes to operate.

## ***Part 1: Information on BT Group***

### ***European Union***

The European Commission has been pursuing a policy of progressive liberalisation and harmonisation in telecommunications. Since January 1998, the provision of infrastructure and all telecommunication services has been liberalised in the EU. Specific directives imposed rules for, among other things, voice telephony, leased lines and interconnection, with particular emphasis on organisations with significant market power and with a common set of principles for licensing and enforcement. These have largely been implemented in national legislation. The European Commission reviewed progress during 1999 and 2000 and is proposing a new regulatory framework, which is expected to come into force around early to mid 2003. This is expected to include a more uniform regulatory treatment of different communications technologies, a revision of the concept of significant market power to be applied by national regulatory authorities and a new market definition and analysis procedure, which national regulatory authorities will have to follow before imposing ex-ante regulation. The new definition of significant market power is expected to be based on competition law concepts of dominance and to be applied in oligopolistic situations of joint or collective dominance.

### ***United States***

In the United States, the Federal Communications Commission has extensive authority to regulate interstate and foreign services, and services provided by common carriers, as well as the authority to implement policies that promote competition for all telecommunication services.

### ***Rest of the world***

The World Trade Organisation's Agreement on Basic Telecommunications, signed in February 1997, created a framework for the progressive opening of telecommunications markets in accordance with world trade standards. The agreement provides assurance that commitments made by the 73 participating nations can be legally enforced. However, the commitments themselves provide only limited opportunities in some markets. A further round of World Trade Organisation negotiations on services is in preparation, though the timing of any agreement which may be reached is uncertain.

### **Other significant changes and issues**

#### ***Local loop unbundling***

In April 2000, BT accepted an amendment to its Licence that required it to provide unbundled local loops to other operators, to enable them to provide telecommunications services, including broadband DSL-type services, to end customers. The amendment came into force in August 2000, with local loop unbundling to be available from July 2001.

The EU thereafter passed a regulation requiring local loop unbundling, line sharing and sub-loop unbundling to be offered from December 2000, thereby bringing forward the implementation date. BT published a revised standard reference offer on 29 December 2000.

By the end of 2001, the Company will introduce line sharing as required by the EU regulation. Oftel will determine the prices for the broadband frequency band of a shared loop after consultation and input by the Company of relevant cost calculations.

Charges for unbundled loops and shared loops are subject to determination by Oftel, which has indicated that it may seek to impose an RPI minus X regime from 2002 onwards. Discussions on the appropriateness of this approach and the level of X have not yet commenced.

#### ***Carrier pre-selection***

From 1 January 2000, the European Commission required the provision of carrier pre-selection ("CPS") by member state operators with significant market power. CPS allows customers to opt for certain classes of call to be carried by an alternative operator, selected in advance, without having to dial additional access codes.

Software changes to BT's local exchanges could not be introduced before January 2001 (for national and international calls) and January 2002 (for all other calls) and the Government applied to the European Commission for a deferment of BT's obligation. The European Commission granted a limited deferment until 1 April 2000, but decided that CPS should be provided in the interim by means of auto-diallers on customers' premises.

BT introduced phase 1 of the permanent CPS service (for national and international calls) ahead of schedule on 12 December 2000. Phase 2 of permanent CPS (for all calls) is on track for launch in December 2001.

### ***Leased lines***

Oftel published a direction in respect of partial private circuits (“PPCs”) in March 2001. This resulted from a review of the competitiveness of the national leased lines market in the UK and the need for regulation in this sector. The direction followed a consultation in August 2000 and an Oftel statement in December 2000. Oftel concluded that more competition was needed in the provision of wholesale “terminating segments” and proposed that BT offer PPCs to other operators at cost-based prices. PPCs were launched on 1 August 2001. However, on 9 August 2001, BT was notified by Oftel that a number of operators consider that they are in dispute with BT and have requested Oftel to make a determination on a range of issues that could affect the price and terms of the offer.

### ***Universal service***

BT responded to Oftel’s most recent consultation on universal service and provided Oftel with evidence of the significant net costs of being the provider of universal service. BT believes that this makes the case for industry-wide funding a strong one and are disappointed that Oftel has yet to acknowledge this. BT endorses Oftel’s view that the scope of the universal service obligation should not yet be extended to include broadband services. Oftel has indicated that it will shortly publish its final conclusions in the form of a Statement.

### ***The Government’s review of telecommunications and broadcasting regulation***

The Government has initiated a review of telecommunications and broadcasting regulation. The Government published a White Paper in December 2000 proposing regulatory reform concerning the convergence of the communications industries. A new regulatory body is proposed, to be called the Office of Communications (“Ofcom”), that will amalgamate the roles of five existing regulatory agencies: Office of Telecommunications; Independent Television Commission; Broadcasting Standards Commission; Radio Authority, and Radiocommunications Authority. Ofcom will be headed by a chairman and chief executive supported by executive and non-executive board members.

The main change for telecommunications would be the proposed introduction of fines for breach of regulatory obligations. BT Group supports the Government’s vision for the converging sector and welcomes the intention not to apply broadcasting rules to internet content. However, BT Group, along with many others, is seeking full rights of appeal against regulatory decisions and the incorporation within Ofcom of incentives to reduce the level of regulation when appropriate. The draft Communications Bill is expected to be published during the 2001/2002 Parliamentary Session. Meanwhile, the Office of Communications Bill was introduced in July 2001, enabling the creation of Ofcom before the Communications Bill achieves Royal Assent, which should enable regulatory functions to be transferred to Ofcom more quickly thereafter.

### ***Interconnection product***

On 26 May 2000, Oftel issued a determination stating that BT should provide an interconnection product under its licence for flat rate internet access call origination (“FRIACO”). The determination required BT to provide call origination for internet access, not on the standard pence per minute basis but with charging based upon network capacity purchased. The determination directed BT to offer FRIACO at the local exchange level from 1 June 2000. BT complied with this requirement. BT had concerns about potential network congestion should FRIACO have to be made available at the next level up from the local exchange (“DMSU”). Oftel has acknowledged these concerns and, on 13 November 2000, began consulting on proposals that would make FRIACO available at the DMSU level, although with safeguards in place for one year to ensure the network does not become congested. A final determination on DMSU FRIACO was issued on 15 February 2001 requiring BT to offer such a product but with safeguards, including requirements on other operators to agree appropriate re-arrangement of traffic with BT until February 2003 to prevent network congestion. The charges for both FRIACO services are to be incorporated in the network charge control regime.

### ***Domestic obligations in a global market***

As a result of BT Group’s international interests, a condition of the Licence prohibits BT from doing anything, by act or omission, that would detract materially from its ability to meet its Licence obligations to provide UK telecommunication services, and to do so to any specified standards. The directors are required to submit an annual compliance certificate to the Director General.

### ***Relationship with the Government***

The Government collectively is BT Group’s largest customer, but the provision of services to any one department or agency of the Government does not comprise a material proportion of BT Group’s revenues. Except as described below, the commercial relationship between BT Group as supplier and the Government as customer has been on a normal customer and supplier basis.

## Part 1: Information on BT Group

BT Group can be required by law to do certain things and to provide certain services for the Government. In addition, the Secretary of State has statutory powers to require BT Group to take certain actions in the interests of national security or international relations.

### 6. Summary financial information

The table below, the contents of which have been extracted without material adjustment from the comparative table on BT in Part 5 of this document, summarises the trading record of the continuing activities of BT, which comprises BT Group, for the three years ended 31 March 2001:

BT Group	Year ended 31 March		
	1999 £m	2000 £m	2001 £m
Group turnover	15,197	16,125	<b>17,130</b>
Total operating profit	3,241	3,169	<b>2,491</b>
Profit on ordinary activities before taxation	4,087	2,964	<b>2,076</b>
Earnings per ordinary BT Group Share — basic <sup>(a)</sup>	40.4p	29.7p	<b>21.6p</b>
Earnings per ordinary BT Group Share — diluted <sup>(a)</sup>	39.5p	29.0p	<b>21.3p</b>

Note:

(a) Restated for the dilutive effects of the Rights Issue but before restatement for the adoption of FRS19 – deferred taxation on 1 April 2001.

### 7. Current trading and prospects

BT Group's operating performance since 31 March 2001, the end of the last financial year, has been satisfactory, although profits have been impacted by increased depreciation, amortisation and interest charges.

Considerable progress has been made in reducing net debt, primarily by means of the Rights Issue and disposals of non-core businesses, and this will benefit future financing costs. Prospects for the remainder of the financial year continue to be satisfactory.

### 8. Recent developments

BT is continuing discussions with AT&T concerning the future of the Concert joint venture. In the event that an unwinding of the Concert joint venture is agreed, and depending on the way that it is implemented, the financial effects on BT Group are likely to include cash and non-cash restructuring costs which could be substantial. These discussions are dealt with in more detail in paragraph 4 of this Part 1.

In addition, BT expects to take an impairment charge against certain of its other investments, including AT&T Canada, in its half year results to 30 September 2001, totalling approximately £500 million. BT Group's investment in AT&T Canada is discussed in more detail in paragraph 4 of this Part 1.

BT expects to complete a sale and leaseback property transaction by 31 December 2001, under which it expects to receive proceeds of approximately £2.3 billion. The Board now expects to reduce net debt to between £15 billion and £17 billion at 31 March 2002 on the assumption that this property sale and leaseback transaction has been completed.

### 9. Dividend policy

BT did not pay a final dividend for the year ended 31 March 2001 and its board has decided that there will be no interim dividend for the year ending 31 March 2002. The Board expects to recommend a final dividend for BT Group in respect of the year ending 31 March 2002 and resume regular dividend payments thereafter. However, the level of dividends which the Company expects to pay is likely to be substantially lower than that paid by BT previously.

### 10. The Board and corporate governance

All of the Directors were previously directors of BT. BT Group's executive directors were appointed to the Board on 10 September 2001. BT Group's non-executive directors will be appointed to the Board with effect from the Demerger Effective Date.

Following the Demerger it is intended to appoint some new directors to the Board.



Details of the Directors are as follows:

### **Chairman**

#### **Sir Francis Christopher Buchan Bland, Chairman (d)**

Sir Christopher Bland was appointed to the board of BT as Chairman on 1 May 2001. He chairs the BT Nominating Committee and the BT Community Support Committee. Sir Christopher has been chairman of the BBC since 1 April 1996 and will continue in that role until the end of September. From 1972 until 1979, he was deputy chairman of the Independent Broadcasting Authority and chairman of its Complaints Review Board. In 1982, he became a non-executive director of LWT Holdings plc and was chairman from 1983 until 1994, when LWT was acquired by Granada Group. From December 1994 to May 2000, Sir Christopher was chairman of NFC plc. From 1977 to 1985, he was chairman of Sir Joseph Causton & Sons plc. Aged 63.

### **Executive Directors**

#### **Sir Peter Leahy Bonfield CBE, Chief Executive (a)**

Sir Peter Bonfield was appointed to the board of BT on 1 January 1996 as Chief Executive. He chairs the BT Executive Committee. Sir Peter is a fellow of the Royal Academy of Engineering and the Institution of Electrical Engineers. From 1981 to 1995, he worked for ICL, latterly as chairman and chief executive. He is a non-executive director of AstraZeneca, a member of the international advisory board of Salomon Smith Barney and vice president of the British Quality Foundation. Aged 57.

#### **Philip Roy Hampton, Group Finance Director (a)**

Philip Hampton was appointed to the board of BT on 1 November 2000 as Group Finance Director. He is an Associate of the Institute of Chartered Accountants. From July 1996, he was a board member of BG Group plc (formerly BG plc) with responsibility for finance, having previously been executive director for finance at British Steel. From 1975 to 1980, he worked for Coopers & Lybrand (now PricewaterhouseCoopers) and between 1981 and 1990 he worked for Lazards. In 1986, he was seconded to Lazard Frères, New York and, in 1987, was appointed an executive director of Lazard Brothers. Aged 47.

### **Non-Executive Directors**

#### **Sir Anthony Armitage Greener, Deputy Chairman (b) (c) (d)**

Sir Anthony Greener was appointed to the board of BT on 1 October 2000. He was appointed chairman of the BT Audit Committee on 1 January 2001. He became BT Deputy Chairman and chairman of the BT Remuneration Committee on 18 July 2001. Sir Anthony is chairman of University for Industry and a non-executive director of Robert Mondavi Corporation. He was formerly chairman of Diageo. Prior to the merger of Guinness and Grand Metropolitan, he was chairman and chief executive of Guinness plc, having been chief executive of Guinness since 1992. Aged 61.

#### **Helen Alexander (b) (d)**

Helen Alexander joined the board of BT on 1 June 1998. She has been chief executive of The Economist Group since January 1997. Helen Alexander joined The Economist in 1984 and was managing director of The Economist Intelligence Unit from 1993 to the end of 1996. She is also a non-executive director of Northern Foods and a member of the ethics committee of the University College London Hospitals. Aged 44.

#### **Maarten Albert van den Bergh (b) (c)**

Maarten van den Bergh was appointed to the board of BT on 1 September 2000. He is chairman of Lloyds TSB Group plc and a non-executive director of The Shell Petroleum Company. Prior to his retirement in July 2000, he was president of the Royal Dutch Petroleum Company and vice chairman of the committee of managing directors from July 1998, having been appointed a managing director of the Royal Dutch Shell Group of companies in July 1992. He is a Dutch national. Aged 59.

#### **Louis Ralph Hughes (b) (c)**

Louis Hughes joined the board of BT on 1 January 2000. He is non-executive chairman of Maxager Technology Inc. (USA). He was formerly president and chief operating officer of Lockheed Martin Corporation and previously executive vice president of General Motors. He is a non-executive director of AB Electrolux (Sweden) and Sulzer AG (Switzerland). From 1993 to 2000, he was a member of the supervisory board of Deutsche Bank. He is a US national. Aged 52.

## **Part 1: Information on BT Group**

### **Edward Neville Isdell** (b) (c) (d)

Neville Isdell joined the board of BT on 1 July 1998. He is vice chairman of Coca-Cola HBC. Neville Isdell joined Coca-Cola in 1968 and has held a number of posts managing Coca-Cola's businesses in various parts of the world, including president of greater Europe. He has served on the boards of the publicly-quoted Coca-Cola Enterprises US and Coca-Cola Amatil Australia. He is a member of the council of the World Economic Forum. He is an Irish national. Aged 58.

### **June Frances de Moller** (c)

June de Moller was appointed to the board of BT on 1 September 1999. A former director of Carlton Communications, she became Carlton's managing director in 1993, stepping down from that position in January 1999. June de Moller is also a non-executive director of Cookson Group, Lynx Group and J Sainsbury. Aged 54.

### **Sir Philip John Weston** (b)

Sir John Weston joined the board of BT on 1 October 1998. He retired as Britain's Ambassador to the United Nations in New York in July 1998. Sir John was formerly British Ambassador to NATO. He is also a non-executive director of Hakluyt & Co. and Rolls-Royce, and honorary president of the UK-wide Community Foundation Network. Aged 63.

### **Company Secretary**

#### **Colin Raymond Green** (a)

Colin Green, a solicitor, joined BT from its predecessor corporation, having joined the Post Office in 1977. Before joining the Post Office, he was a partner in a private practice. He was appointed Secretary and Chief Legal Adviser of BT in 1994. On 1 April 1999, he became Group Commercial Director and Secretary. Aged 52.

### **Key to membership of principal BT Board committees:**

- (a) *Executive*
- (b) *Audit*
- (c) *Remuneration*
- (d) *Nominating*

### **Corporate governance**

BT Group will adopt equivalent standards of corporate governance to BT. BT Group is committed to achieving best practice in its standards of corporate governance and business integrity throughout the BT Group. The Board will use its best endeavours to comply with the Combined Code. It is expected that the Board will meet at least 11 times a year. The Board will have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with.

The Board will establish an audit committee, a remuneration committee and a nominating committee before the Demerger Effective Date.

The audit committee will review the systems of risk management and internal controls, including financial, operational and compliance policies and practices. It will also consider the form and content of published financial reports and statements for statutory compliance and against standards of best practice, and recommend to the Board appropriate disclosure in these reports. The audit committee will also review the scope and results of the external audit and its cost effectiveness, as well as the performance of the auditors and provision of non-audit services to the Company. The committee will meet at least four times a year.

The remuneration committee will have responsibility for determining the remuneration policy for the Chairman and specified senior executives. The committee will meet at least four times a year.

The nominating committee will recommend to the Board appointments of all directors. This committee will meet as required.

# Part 2: Further information relating to the Scheme, the Demerger and the BT Group Reduction of Capital

## 1. Description of the Proposals

The demerger of mmO<sub>2</sub> from BT and the establishment of the Company as the holding company for the BT Group entails a number of steps.

### The Scheme

As the first stage, a new holding company, mmO<sub>2</sub> plc, will become BT's ultimate holding company pursuant to a scheme of arrangement under section 425 of the Companies Act, subject to certain conditions, including the approval of BT Shareholders and the approval of the Court.

Under the terms of the Scheme, BT Shareholders at the Scheme Record Time will exchange their BT Shares for mmO<sub>2</sub> Shares on the following basis:

*for each BT Share* *one mmO<sub>2</sub> Share*

Under the Scheme:

- (a) the BT Shares will be cancelled and the holders of BT Shares at the Scheme Record Time will be allotted one mmO<sub>2</sub> Share, credited as fully paid, for each BT Share then held; and
- (b) following the cancellation of the BT Shares, the issued share capital of BT will be restored to its former amount by applying the reserve arising in the books of BT as a result of the cancellation of the BT Shares in paying up in full new ordinary shares of an equivalent nominal amount. These will be issued to mmO<sub>2</sub> plc (and/or its nominees).

As a result, mmO<sub>2</sub> plc will become the holding company of BT Group and will be owned by the former BT Shareholders. Except in the circumstances described below, mmO<sub>2</sub> plc will remain the holding company of BT Group only until completion of the Demerger which is expected to take place a short time after the Scheme becomes effective.

The Scheme is not conditional upon the Demerger proceeding, but the Demerger will not proceed unless the Scheme has become effective. In the event that the Demerger does not proceed, the new holding company created under the Scheme will be the holding company for the BT Group with the name BT Group plc, its board of directors will comprise the existing directors of BT (save for Dr Iain Anderson) and it will adopt the same principles of corporate governance as BT.

### The Demerger

Under the Demerger, subject to certain conditions, including the approval of BT Shareholders at the EGM, the Company will issue BT Group Shares to mmO<sub>2</sub> plc Shareholders at the Demerger Record Time on the following basis:

*for each mmO<sub>2</sub> Share* *one BT Group Share*

In summary, therefore, if the Scheme and Demerger are approved and implemented in full as contemplated, **BT Shareholders will receive the same number of shares in each of the Company and mmO<sub>2</sub> plc as the number of BT Shares that they previously held.**

The Demerger is expected to be effected as follows:

- (a) after the Scheme has become effective, BT will transfer O<sub>2</sub> Limited, a wholly owned subsidiary which is currently the holding company of the mmO<sub>2</sub> Group, to mmO<sub>2</sub> plc for a consideration equal to its book value as shown in the accounts of BT, with such amount left outstanding as an inter-company debt;
- (b) BT will pay a dividend to mmO<sub>2</sub> plc of an amount equal to the aggregate of the book value of BT as shown in the accounts of mmO<sub>2</sub> plc and the expenses expected to be incurred by mmO<sub>2</sub> plc in connection with the Proposals;
- (c) mmO<sub>2</sub> plc will transfer BT to a wholly owned subsidiary, BT Group Investments, for a combination of inter-company debt and shares;
- (d) the debt owed by mmO<sub>2</sub> plc to BT described in paragraph (a) above will be assumed by BT Group Investments (in substitution for mmO<sub>2</sub> plc) in consideration for the discharge of the debt owed by BT Group Investments to mmO<sub>2</sub> plc described in paragraph (c) above; and
- (e) mmO<sub>2</sub> plc will declare a dividend of an amount equal to the book value of its shareholding in BT Group Investments (the "Demerger Dividend") which will be satisfied *in specie* by the issue by the Company of shares, credited as fully paid, to

## ***Part 2: Further information relating to the Scheme, the Demerger and the BT Group Reduction of Capital***

mmO<sub>2</sub> plc Shareholders on the basis set out above, in consideration of the transfer of BT Group Investments (together with its then wholly owned subsidiary BT) to the Company.

As part of the Scheme, the Court will be asked to approve the loan to the trustees of a special purpose trust (which will be established by BT to enable BT Group Shares and mmO<sub>2</sub> Shares to be provided to participants in certain BT share option schemes on exercise of their options) and the steps set out in sub-paragraphs (a) and (d) above. The Court will also be asked to approve the payment by BT of the costs and expenses relating to the Proposals. Without such approval, those steps would or might be unlawful as involving financial assistance prohibited by section 151 of the Companies Act.

### **The BT Group Reduction of Capital**

The BT Group Reduction of Capital will, subject to certain conditions, including the approval of BT Shareholders at the EGM, be implemented following the Demerger to increase the level of reserves available for future distributions to shareholders of the Company or otherwise to facilitate any future transactions. Under the BT Group Reduction of Capital, the capital of the Company will be reduced by decreasing the nominal amount of each issued BT Group Share from 115 pence to 5 pence. The existing shareholders of the Company have already resolved, conditional on the BT Group Shares being issued pursuant to the Demerger, to reduce the capital so issued. The BT Group Reduction of Capital will also require the confirmation of the Court and, if so confirmed, will create a new reserve in the books of the Company of approximately £9.5 billion which will be available for future distribution to shareholders of the Company or otherwise to facilitate any future transactions at the discretion of the directors of the Company.

### **Notes and bondholders and third party consents**

The Board is mindful of BT's obligations to the holders of its outstanding notes and bonds and has consulted with The Law Debenture Trust Corporation p.l.c. which is trustee of certain of the notes and bonds. The trustee has taken independent legal and financial advice and has confirmed to BT that it will not take any steps in relation to the Demerger.

BT will request the confirmations and/or consents that are required from third parties in relation to those businesses, assets or contracts which it believes, either alone or together with other businesses, assets or contracts, are or may be material to BT. Although the Directors believe that all material confirmations and/or consents should be received in time for the Proposals to be implemented in accordance with the Expected Timetable of Principal Events, there can be no assurance that this will be the case. The implementation of each of the Scheme and the Demerger is conditional on BT receiving confirmations and/or consents from relevant regulatory authorities and other third parties in a form satisfactory to it, or the Directors being satisfied that sufficient confirmations and/or consents have been received such that the Scheme and/or the Demerger are in the best interests of BT as a whole.

Where a confirmation or consent which is required for the implementation of the Scheme or the Demerger is not obtained prior to the Scheme Effective Time or the Demerger Effective Time respectively, the Directors will need to consider the materiality of the business, asset or contract to which that confirmation or consent relates, together with the consequences of proceeding without the confirmation or consent. These consequences will depend on the value of the business, asset or contract and the rights which are conferred on third parties if the Scheme or Demerger is implemented without confirmation or consent.

BT has already received confirmation from The Department of Trade and Industry that it would not be minded to revoke the licences granted to BT, BT Cellnet and BT3G Limited under Section 7 of the Telecommunications Act 1984.

## **2. Admission and dealings**

Application has been made to the UK Listing Authority for up to 8,700,000,000 BT Group Shares to be admitted to the Official List and to the London Stock Exchange for such shares to be admitted to trading on the London Stock Exchange. The last day of dealings in BT Shares is expected to be 16 November 2001. Admission of the BT Group Shares to the Official List will become effective and dealings in the BT Group Shares will commence at 8.00 a.m. on the Demerger Effective Date, which is expected to be 19 November 2001.

A supplemental application will be made to list the BT Group ADSs, each representing 10 BT Group Shares, on the New York Stock Exchange. It is expected that this application will become effective and that trading of the BT Group ADSs on the New York Stock Exchange will commence at 9.30 a.m. New York time on 19 November 2001. No application is being made to list the BT Group Shares in Japan.

BT Group Shares can be held in certificated or uncertificated form. At the Scheme Effective Time, share certificates for the BT Shares will cease to be valid and, with respect to the BT Shares held in uncertificated form, CRESTCo will be instructed to cancel the entitlements of the relevant BT Shareholders with respect to those BT Shares. The last date for registration of transfers of BT Shares is expected to be 16 November 2001.

It is expected that certificates for BT Group Shares will be posted by 30 November 2001.

Pending the despatch of certificates for BT Group Shares, transfers of BT Group Shares in certificated form will be certified against the share register of BT Group. Temporary documents of title have not been and will not be issued in respect of the BT Group Shares.

It is expected that BT Group Shares will be credited to CREST accounts on 19 November 2001.

All documents, certificates, cheques or other communications sent by or to shareholders will be sent at their own risk and may be sent by post.

All mandates relating to payment of dividends on BT Shares, all instructions relating to BT's dividend reinvestment plan and all instructions given to BT in relation to notices and other communications in force immediately prior to the Scheme Effective Time will be, unless and until revoked or varied, deemed as from the Scheme Effective Time to be valid and effective mandates or instructions to BT Group in relation to the corresponding holdings of BT Group Shares. Such mandates and instructions will also be deemed, as from the Demerger Effective Time to be valid and effective mandates or instructions to mmO<sub>2</sub> plc in relation to the corresponding holdings of mmO<sub>2</sub> Shares. This will not extend to communications relating to the receipt of summary financial statements. BT Group expects to send notices to its shareholders relating to the receipt of summary financial information shortly after the Proposals have become effective.

### **3. Continuing relationship between the Company and mmO<sub>2</sub> plc**

Prior to the Demerger, mmO<sub>2</sub> operates largely through subsidiaries, as a division of BT. However some of its internal organisation and parts of its internal procedures are integrated with those of BT. Immediately following the Demerger, neither the Company nor mmO<sub>2</sub> plc will have any shareholding in the other and BT Group and mmO<sub>2</sub> Group will operate as separate businesses.

The Company, BT, mmO<sub>2</sub> plc and members of mmO<sub>2</sub> Group have entered into several agreements for the purpose of giving effect to the Demerger and defining the continuing relationship between BT Group and mmO<sub>2</sub> Group, which have been concluded as a result of arm's length negotiations and are summarised below.

#### **Demerger Agreement**

On 18 September 2001, BT Group plc, BT and mmO<sub>2</sub> plc entered into a demerger agreement (the "Demerger Agreement") which sets out the obligations of the parties in implementing the steps to achieve the Demerger.

Under this agreement, subject to the satisfaction of a number of conditions, including the passing of the resolution to approve the Demerger Dividend at the EGM and the board of mmO<sub>2</sub> plc approving the Demerger as being in the best interests of the Group, mmO<sub>2</sub> plc has agreed to transfer BT Group Investments to the Company and, in exchange for such transfer, the Company has agreed to allot and issue (subject only to Admission of the BT Group Shares) BT Group Shares to the mmO<sub>2</sub> Shareholders in satisfaction of the Demerger Dividend such that each mmO<sub>2</sub> Shareholder at the Demerger Record Time will be entitled to receive one BT Group Share for each mmO<sub>2</sub> Share then held. No party to the Demerger Agreement has given any representation, warranty or indemnity to the others and no party has any right to rescind the agreement.

#### **Separation Agreement**

On 18 September 2001, BT, the Company, mmO<sub>2</sub> plc and O<sub>2</sub> Limited entered into a separation agreement (the "Separation Agreement"), which will cease to be effective if the Demerger does not become unconditional by 31 March 2002. Under the Separation Agreement, it has been agreed that mmO<sub>2</sub> will have net debt (excluding trading balances) of approximately £500 million on the Demerger Effective Date, including loan indebtedness to BT Group. The Company and mmO<sub>2</sub> plc have agreed that, immediately following the Demerger being implemented, the mmO<sub>2</sub> Group will repay the outstanding inter-company debt (other than trading balances) owed to the BT Group. Trading balances owed between the BT Group and the mmO<sub>2</sub> Group will be settled in the ordinary course of business in accordance with the trading agreements governing those arrangements.

## ***Part 2: Further information relating to the Scheme, the Demerger and the BT Group Reduction of Capital***

Following the Demerger becoming effective, the Company and mmO<sub>2</sub> plc have also agreed to allocate certain assets and liabilities and rights and obligations, in each case relating to the mmO<sub>2</sub> business, between their respective groups. mmO<sub>2</sub> plc will be responsible for insuring the ongoing activities of its business following the Demerger becoming effective.

The allocation of assets and liabilities in the Separation Agreement supplements the asset and share transfer agreements entered into between members of the BT Group and the mmO<sub>2</sub> Group to effect the internal reorganisation which took place to create the mmO<sub>2</sub> Group as a distinct sub-group of BT. The Separation Agreement provides that the parties shall use all reasonable endeavours to procure the transfer to the mmO<sub>2</sub> Group of any assets or liabilities relating exclusively to the mmO<sub>2</sub> businesses and the transfer to the BT Group of any assets or liabilities relating exclusively to the BT Group businesses which have not been transferred to the mmO<sub>2</sub> Group or the BT Group, as appropriate, by the date the Demerger becomes effective. However, this arrangement is subject to, and does not seek to change, the way in which BT and O<sub>2</sub> Limited have agreed to deal in the internal reorganisation, with certain identifiable assets, such as intellectual property rights.

In addition, under the Separation Agreement, the Company and mmO<sub>2</sub> plc have agreed, subject to certain limited exceptions, to indemnify each other against certain actual and contingent liabilities to the extent arising directly or indirectly out of their respective businesses. The purpose of these indemnities is to ensure effective implementation of the principles on which it has been agreed that assets and liabilities should be allocated between the Company and mmO<sub>2</sub> plc. Furthermore, the Company and mmO<sub>2</sub> plc have agreed to indemnify one another against certain liabilities arising from certain incomplete, false or misleading information provided by either of the Company or mmO<sub>2</sub> plc, or their respective groups, for inclusion in public documents. Such indemnities apply indefinitely and are not subject to any financial limit.

The Separation Agreement contains no representations or warranties by any party.

mmO<sub>2</sub> plc has agreed that, after the Demerger has become effective, it will seek to obtain a full and effective release of each relevant member of the BT Group from any guarantees, undertakings and indemnities which such BT Group member may have given in respect of the mmO<sub>2</sub> Group, including an undertaking of support in respect of Viag Interkom's licence obligations.

When Viag Interkom acquired both its GSM and UMTS licences in Germany, BT undertook to Viag Interkom to provide it with financial support for the roll-out and operation of Viag Interkom's GSM and UMTS networks pursuant to these licences in proportion to its then shareholding in Viag Interkom. At the time BT achieved full control of Viag Interkom, it amended those undertakings to reflect its one hundred per cent. ownership. mmO<sub>2</sub> plc will give corresponding undertakings of financial support in respect of Viag Interkom's outstanding licence obligations as are appropriate to replace those given by BT.

Each of the Company and mmO<sub>2</sub> plc has agreed to make certain information available to the other in so far as it is reasonably necessary for the other's commercial affairs and, in particular, for the purpose of preparing financial statements or complying with regulatory requirements.

Under the Separation Agreement, the Company and mmO<sub>2</sub> plc have agreed that certain costs of the Demerger shall be apportioned between them as they may agree in writing.

The Separation Agreement also sets out an informal, non-binding dispute resolution procedure which the Company and mmO<sub>2</sub> plc have agreed shall be applied to the resolution of key disputes which may arise between them and their respective groups in connection with their continuing relationship and the Demerger. These arrangements are intended to limit the time and costs involved in resolving such disputes that may arise between the parties before recourse to the courts or any other chosen binding resolution procedure.

The Separation Agreement also sets out the parties' agreement for the separation of the pensions arrangements of the BT Group and the mmO<sub>2</sub> Group. These arrangements are described in more detail below.

Under a separate arrangement the Company and mmO<sub>2</sub> plc have agreed that mmO<sub>2</sub> plc will pay the remaining amount of approximately US\$20 million due in respect of the 1,500,000 non-voting shares in Esat Digifone Limited (now Digifone mmO<sub>2</sub> Limited) acquired in April 2000.

### **Pensions Arrangements**

The Separation Agreement described above sets out in a schedule the terms on which mmO<sub>2</sub> plc and BT have agreed to deal with the pensions arrangements for the BT Group and the mmO<sub>2</sub> Group affected by the Demerger. The pensions schedule provides for

participation by mmO<sub>2</sub> plc and its subsidiaries in the BT Pension Scheme and other BT pensions arrangements to continue in respect of their employees for a maximum period of twelve months after the Demerger Effective Date.

During the participation period mmO<sub>2</sub> plc will contribute in respect of employees who are members of the BT Pension Scheme at the rate of 11.6 per cent. of such employees' pensionable salaries and employees will continue to contribute 6 per cent. of pensionable salary.

The pensions schedule of the Separation Agreement also provides for the making of a transfer payment, subject to certain conditions, following the end of the participation period in respect of those members of the BT Pension Scheme who consent to the transfer of their past service benefits from the BT Pension Scheme to a new pension arrangement to be established by mmO<sub>2</sub> plc. mmO<sub>2</sub> plc intends that those arrangements will provide benefits which are broadly equivalent in actuarial value to those accruing under the BT Pension Scheme. The pensions schedule also provides that the transfer payment will be calculated on a past service reserve basis (that is, based on accrued rights with an allowance for projected future salary increases) in accordance with actuarial methods and assumptions set out in the pensions schedule. Under the pensions schedule BT agrees to use its best endeavours to procure the payment by the trustees of the BT Pension Scheme of the transfer payment. If the transfer amount is not paid in full by the trustees, then BT is obliged to make up the shortfall up to a maximum of £30 million. Under the pensions schedule, mmO<sub>2</sub> will be indemnified by BT against any liability it has to the BT Pension Scheme following the Demerger (other than liability to continue to make ordinary and certain additional contributions for the duration of the participation period as set out in the pensions schedule) and in relation to any potential past service liability for the non-recognition of employees' part time service and non-compliance with any obligation to replicate civil service benefits.

### **Tax Agreement**

On 18 September 2001, the Company and mmO<sub>2</sub> plc entered into a tax agreement (the "Tax Agreement") which will cease to be effective if the Demerger Agreement does not become unconditional before 31 March 2002. The Tax Agreement contains provisions relating to, among other things, the allocation of tax liabilities between the BT Group and the mmO<sub>2</sub> Group, the manner in which the groups will prepare and agree tax computations and returns, the basis on which certain claims and elections can be made (including the surrender of tax reliefs from one group to the other and the ability of the BT Group to "roll over" capital gains into assets owned by the mmO<sub>2</sub> Group), the conduct of negotiations and disputes with the tax authorities, the exchange of information relating to their tax affairs and certain other administrative matters.

The two general principles underlying the Tax Agreement are that:

- each group company shall be responsible for its own tax liabilities, whether arising before, after or as a result of the Demerger becoming effective; and
- the two groups shall co-operate to try to minimise the aggregate tax liabilities of members of the groups for accounting periods beginning before the Demerger is effected.

There are certain limited exceptions to these general principles.

The Company and mmO<sub>2</sub> plc have agreed that they shall respectively be responsible for the preparation of the tax computations and returns for the members of their respective groups for all periods both before and after the Demerger becoming effective, and deal with all negotiations, correspondence and agreements with the tax authorities with respect to those computations and returns, subject to certain limited exceptions. mmO<sub>2</sub> plc has agreed to procure the surrender of losses to members of the BT Group and to permit certain capital gains realised by members of the BT Group to be rolled over for UK tax purposes into certain assets of the mmO<sub>2</sub> Group.

The parties have agreed that each group shall be responsible for conducting any negotiations or disputes with the tax authorities relating to the tax liabilities of that group, subject to certain limited exceptions.

### **Framework Agreement**

BT entered into a framework agreement (the "Framework Agreement") on 31 May 2001 with O<sub>2</sub> Limited which prescribes that, prior to and following the Demerger, each will deal with the other, and will procure that their respective subsidiaries deal with each other on an arm's length basis in the UK, on commercial terms and that each will treat the other and its subsidiaries as independent trading entities. The Framework Agreement also prescribes certain terms and conditions which apply across the various UK trading and shared services agreements between BT and its subsidiaries and O<sub>2</sub> Limited and its subsidiaries described in this paragraph 3, subject to certain exceptions. For the purposes of the Framework Agreement and those trading and shared services agreements, the UK includes the Isle of Man.

## ***Part 2: Further information relating to the Scheme, the Demerger and the BT Group Reduction of Capital***

If there is a conflict between the provisions of a trading or shared services agreement in the UK and the Framework Agreement, the trading or shared services agreement will take precedence.

The Framework Agreement is effective from 31 May 2001 and for an initial period of 12 months, terminable by BT or by O<sub>2</sub> Limited on three months' written notice taking effect after the initial 12 month period. Expiry of the Framework Agreement will not affect the continuance of any trading agreement entered into pursuant to it. However, over time the mmO<sub>2</sub> Group intends to reduce the importance of its relationship with the BT Group.

No monetary consideration is payable under this agreement. Neither party to it gives any representation, warranty or indemnity.

The terms and conditions of the Framework Agreement do not apply to agreements between BT and O<sub>2</sub> Limited or their respective subsidiaries for network services and telecommunications services, which are and will continue to be provided, where relevant, on standard arm's length terms and conditions that are applicable to other recipients of such services, or to arrangements for the use of BT properties by the mmO<sub>2</sub> Group, which are addressed separately and for which the provisions of the Framework Agreement are not appropriate.

Framework agreements have not been entered into by members of the mmO<sub>2</sub> Group in relation to its business in Germany, The Netherlands and Ireland. Nevertheless, their trading arrangements with the BT Group in these countries are and will continue to be on arm's length terms.

The key trading and shared services agreements that the BT Group have agreed with the mmO<sub>2</sub> Group may be summarised as follows:

### **Trading Agreements**

**IT Master Services Agreement.** BT entered into an agreement with O<sub>2</sub> Limited and BT Cellnet on 18 September 2001, under which BT has agreed to provide O<sub>2</sub> Limited and the other members of the mmO<sub>2</sub> Group in the UK with IT services of a project nature such as systems integration, and with IT services of a continuous nature such as desktop support, web hosting, billing services, consultancy services and other support services. The UK mmO<sub>2</sub> Group companies will continue to receive these services from different divisions within the BT Group. The IT Master Agreement is designed to harmonise the legal structure for the provision by the different divisions within the BT Group of IT services to such mmO<sub>2</sub> Group companies which provide such services. In general, BT or members of the mmO<sub>2</sub> Group may terminate services of a continuous nature on industry standard notice periods. However, BT has, in respect of certain key services, agreed to use all reasonable endeavours to ensure that the UK mmO<sub>2</sub> Group companies continue to receive from the BT Group, on an arm's length basis, the IT services that were provided to such companies before the Demerger for at least a transitional period.

**Telecommunications Services.** In the UK, Germany, The Netherlands and Ireland there are a series of agreements between members of the mmO<sub>2</sub> Group and members of the BT Group governing the provision of telecommunications services between them such as voice, data and telephony services. These agreements vary in term but, in general in the UK such services are supplied on standard published terms and conditions. Elsewhere, agreements are based on terms and conditions generally applicable to such services offered by the relevant party.

**Network Agreements.** In the UK, Germany, The Netherlands and Ireland there are a series of network agreements between members of the BT Group and the mmO<sub>2</sub> Group governing the provision of operator to operator services including, for example, the provision of private circuits, frame relay services and interconnection services. These agreements vary in term but in general, in the UK interconnection is on BT's standard published terms for interconnection. Elsewhere, agreements are based on terms and conditions generally applicable to such services offered by the relevant party.

**Field Operation Services and Maintenance Agreements.** In the UK, BT has entered into several agreements with certain members of the mmO<sub>2</sub> Group that provide that BT will maintain cell site equipment and the core network switching infrastructure relating to various networks in the UK, including BT Cellnet's principal network and paging network. These agreements vary in term. The most significant of these agreements, relating to BT Cellnet's principal network, has a term of five years, terminable on between three and 12 months' notice, depending on the circumstances.

**PMP (Point to Multi-Point) Frequency Usage Agreement and Side Letters.** In Germany, Viag Interkom, a member of the mmO<sub>2</sub> Group, holds licences for the use of local loop frequencies. For regulatory reasons, the licences for use of such frequencies, which are used by the BT Ignite fixed-line business rather than by Viag Interkom's mobile business, cannot be transferred to BT Ignite. For this reason, Viag Interkom has granted to BT Ignite an irrevocable and exclusive right to exploit such frequencies as if BT Ignite, to the extent permitted by law, were the licensee. The agreement provides for a penalty to be paid by Viag Interkom to BT Ignite if, other than



as a result of acts or omissions by BT Ignite, or as a result of lawful governmental, regulatory or legal restrictions or requirements, any of these frequencies or licences are revoked and BT Ignite is prevented from carrying on its services.

The agreement will terminate automatically in the event that all of the frequencies and frequency licences are lawfully transferred and/or assigned to BT Ignite. Viag Interkom has agreed with BT Ignite to seek consent from the relevant German regulatory authority to the transfer of these frequencies and licences from Viag Interkom to BT Ignite. In addition, Viag Interkom has agreed to provide BT Ignite with consultancy services relating to the management of existing PMP sites and, at BT Ignite's request, any future PMP sites. BT Ignite may terminate the PMP Frequency Usage Agreement in whole or with respect to a particular frequency, by giving Viag four weeks' notice of termination.

**Technical Services Agreement.** O<sub>2</sub> Limited entered into a framework agreement with BT (trading as BTexact Technologies) on 18 September 2001 under which O<sub>2</sub> Limited may request BTexact Technologies to provide mmO<sub>2</sub> Group companies with research, development and/or consultancy services in accordance with individual work packages agreed from time to time between O<sub>2</sub> Limited and BT. The agreement has a term of three years, although work packages may be negotiated for a longer period and would continue to be governed by the agreement. The agreement is on arm's length terms. Charges are agreed as and when the commercial terms of individual work packages are agreed. Either party may terminate the agreement or a work package if the other commits a material breach or upon insolvency related events affecting the other party.

### **Wireless Trading Agreement**

This agreement was entered into by BT and BT Cellnet on 14 September 2001. It provides that BT will continue to promote exclusively BT Cellnet's mobile telecommunications products and services to the business market in the UK. This agreement is for an initial term of three years and may be terminated by either party if certain performance targets are not met by the other. Either party may also terminate the agreement upon, amongst other things, material or persistent breach or insolvency proceedings. Either party may also terminate the agreement upon twelve months' notice following a change of control of the other party.

BT Cellnet will pay BT a percentage of the revenue it receives for sales to business customers introduced by BT. BT may also buy mobile network capacity from BT Cellnet at wholesale prices in order to provide communication solutions to its own business customers. BT has undertaken to ensure that a specified minimum level of revenue will be generated for BT Cellnet by sales through BT to business customers contracting directly with BT Cellnet through BT as an agent rather than through wholesale sales by BT Cellnet to BT. Subject to certain limited exceptions, BT has agreed not to solicit business customers which have contracts with BT Cellnet at the time the agreement was entered into.

Furthermore, for a period of three years, in the UK, BT will not, subject to certain specified exceptions, create its own mobile telecommunications network or virtual mobile telecommunications network or incur significant costs in the provision or sale of major wireless billing systems or major wireless network products for the purpose of providing wireless services to business customers. BT is permitted, however, amongst other things, to continue to provide network building services, outsourcing services, network capacity services to wholesale customers, research and development services, systems integration and management of infrastructure services.

BT is permitted to sell competing mobile services to consumers and to both business customers and consumers through certain marketing channels targeted at consumers, including BT's internet domains. In specified circumstances, BT may sell competing mobile services to business customers which have requested a service other than BT Cellnet's, provided BT has offered BT Cellnet the opportunity to offer a service to such a customer.

Each party indemnifies the other for liability arising from breach of this agreement and any tortious act or omission. Other than in respect of liability arising from infringement of intellectual property rights, death or personal injury due to negligence or failure to pay charges properly due under this agreement, the liability of each party is limited in any annual period to £5 million.

### **Shared Services Agreements**

**Administrative Services.** In the UK, Germany and The Netherlands, members of the BT Group have entered into a number of agreements with members of the mmO<sub>2</sub> Group under which such BT Group members will provide the mmO<sub>2</sub> Group with many of the administrative non-network services that it receives as part of the Group before the Demerger. The services covered by these agreements include, for example, services in respect of property management, payroll, customer billing and human resources. Administrative services required by Genie in jurisdictions other than the UK, Germany and The Netherlands are provided by the BT Group under the UK administrative services agreement.

## ***Part 2: Further information relating to the Scheme, the Demerger and the BT Group Reduction of Capital***

In addition, in the UK, Germany and The Netherlands, members of the mmO<sub>2</sub> Group provides certain administrative services to the BT Group.

It is anticipated that most services provided under these agreements will be provided by the BT Group to members of the mmO<sub>2</sub> Group and vice versa on a transitional basis only. However, some services are expected to continue to be provided for a longer period until terminated in accordance with the relevant administrative services agreement. For example, in Germany, BT Ignite will provide risk management services in respect of mmO<sub>2</sub>'s web-based Geographic Information Systems for an indefinite period, subject to termination on one month's notice.

**Site Sharing and Occupancy Licences.** In the UK, Ireland and Germany there are agreements between members of the BT Group and members of the mmO<sub>2</sub> Group that provide members of the mmO<sub>2</sub> Group with access to and use of office premises and technical equipment premises and, in the UK and Ireland, cell site premises, which are currently owned or leased by the BT Group, but occupied by members of the mmO<sub>2</sub> Group.

In the UK, around 9 per cent. of the cell sites which form part of BT Cellnet's principal network are on premises owned or leased by BT.

In addition, in Ireland the site sharing agreement between BT Group and the mmO<sub>2</sub> Group provides for the BT Group to access and use technical equipment sites currently leased by mmO<sub>2</sub>.

The rent payable in respect of each of the properties covered by these agreements varies depending on the premises occupied. However, in each case the level of rent is market rate. The term of each of these agreements varies according to use.

**Trade Marks, Domain Names and Branding.** O<sub>2</sub> Limited and BT Cellnet entered into a Trade Mark and Domain Name Licence Agreement with BT on 18 September 2001. Under this agreement, mmO<sub>2</sub>'s UK businesses and Telfort Mobiel's business in The Netherlands have been granted the right until 31 March 2003 to continue to use the letters "BT" (including the stylised "BT" corporate logo), the BT full piper logo and the BT half piper logo, to the extent that they used such names and logos immediately before the Demerger, except in respect of fixed line telephony goods and services and all other hardware and telecommunications equipment and certain internet related services. BT is only entitled to terminate the licence in limited circumstances, such as a breach of the licence by an mmO<sub>2</sub> Group member, or where such mmO<sub>2</sub> Group member is affected by insolvency related proceedings. In any event, the mmO<sub>2</sub> Group is obliged to phase out all use (including use in domain names) of the letters "BT" (including the stylised "BT" corporate logo), the BT full piper and the BT half piper by 31 March 2003.

BT, O<sub>2</sub> Limited and BT Cellnet have provided various undertakings in relation to the way in which they use and maintain in force the licensed marks and domain names. On termination of the licence, O<sub>2</sub> Limited and BT Cellnet are required to transfer to BT any domain names still in possession of the mmO<sub>2</sub> Group that contain the letters "bt". On termination of the licence, in order to avoid confusion in the market place, BT, O<sub>2</sub> Limited and BT Cellnet will seek to agree, on a case by case basis, a reasonable period of time (not exceeding two years) during which BT may not re-use (with and/or without the "bt" prefix) certain domain names and trade marks containing the "bt" prefix which were previously owned by, or licensed under the Trade Mark and Domain Name Licence, to a member of the mmO<sub>2</sub> Group. On termination of the licence the mmO<sub>2</sub> Group shall keep its common law and registered trade mark rights in the brands that it owns, such as Cellnet.

The licence is royalty free during its term provided that the relevant mmO<sub>2</sub> Group member complies with its terms. BT has a limited right to charge royalties in the event that the relevant mmO<sub>2</sub> Group member does not meet certain quality standards.

Until expiration of the licence, BT has agreed that the BT Group will not use or licence the letters "BT" (including the stylised "BT" corporate logo), the BT full piper or the BT half piper logo in respect of mobile handsets, SIM cards or the provision of mobile airtime to consumers in the UK, except that BT may use such brands in these areas alongside other mobile network operators (as part of a co-branding exercise) and as part of a bundled offering to UK consumers.

In Ireland, mmO<sub>2</sub> has a non-exclusive licence from the BT Group to use the "Esat" mark. The BT Group may terminate this licence on six months' notice. The mmO<sub>2</sub> Group is confident that it would be able to rebrand in such a period.

**Intellectual Property Licence.** O<sub>2</sub> Limited and BT Cellnet have a non-exclusive royalty-free licence from BT permitting them and the other mmO<sub>2</sub> Group members to continue to use any and all patents, copyrights, unregistered design rights, database rights and know-how, which BT owns and which mmO<sub>2</sub> uses in connection with its world-wide businesses as they are carried on immediately prior to the Demerger to the extent that mmO<sub>2</sub> uses such rights in its respective businesses immediately prior to the Demerger. BT is only entitled to terminate the licence following an insolvency related event affecting O<sub>2</sub> Limited.

## **Airwave**

The Airwave business provides radio network services to certain public safety organisations in the UK. In February 2000, BT was awarded a contract by the UK Government to provide mobile radio services for a number of police authorities. In addition to this contract, BT entered into a number of separate contracts with police authorities detailing the services to be provided to those authorities. By a business transfer agreement dated 18 September 2001 between BT and O<sub>2</sub> Limited, BT agreed to transfer the Airwave business to a subsidiary of O<sub>2</sub> Limited, including these contracts. Pursuant to this agreement, the parties have agreed to sub-contract the future performance of BT's obligations under any service contracts with the police authorities which has not transferred to O<sub>2</sub> Limited by Demerger and O<sub>2</sub> Limited has agreed to indemnify BT for certain liabilities under those contracts until they have transferred to O<sub>2</sub> Limited.

Airwave has the opportunity to generate further revenues on a competitive basis from other public safety users such as fire and ambulance services. It is expected that O<sub>2</sub> Limited and BT will conclude an agreement to enable BT's distribution channels to serve this market.

## **4. Overseas persons**

### **(a) Australia**

This document has not been, and will not be, lodged with the Australian Securities and Investments Commission as a disclosure document for the purpose of Australia's Corporations Act 2001 (Cwlth).

Shares in the Company issued as a result of the Demerger may not be offered for sale in Australia for at least 12 months after their issue, except in circumstances where disclosure to investors is not required under Chapter 6D of the Corporations Act 2001 or unless a compliant disclosure document is produced. Disclosure to investors would not generally be required under Chapter 6D where:

- (i) the shares are offered for sale on the London Stock Exchange;
- (ii) the shares are offered for sale to the categories of "professional investors" described in section 708(11) of the Corporation Act; or
- (iii) the shares are offered for sale to persons who are "sophisticated investors" and meet the criteria set out in sections 708(8) or 708(10) of the Corporations Act.

However, Chapter 6D of the Corporations Act is complex and, if in any doubt, shareholders should confer with their professional advisers regarding the position.

The information in this document is not suitable to be acted upon as investment advice. Shareholders should consider seeking personal investment advice from a suitably qualified person before making any investment decisions relying on the information contained in this document.

### **(b) Canada**

The issue of the BT Group Shares and BT Group ADSs in Quebec is subject to the approval of the Quebec Securities Commission. The issue of the BT Group Shares and BT Group ADSs in British Columbia, Saskatchewan, Manitoba, Ontario, Nova Scotia and Newfoundland is subject to BT obtaining exemptive relief from the appropriate securities commission. Exemptive relief is being sought but no assurance can be given that this relief will be forthcoming. The Company is not a reporting issuer in Canada. Accordingly, in certain provinces or territories of Canada, persons who receive BT Group Shares and BT Group ADSs pursuant to the Demerger may be restricted from disposing of such BT Group Shares and BT Group ADSs as the case may be, in the absence of regulatory relief. Subject to compliance with certain conditions, exemptions from the restrictions on resale of the BT Group Shares and BT Group ADSs are available in British Columbia, Alberta, Manitoba, Ontario and New Brunswick. Discretionary rulings will be sought in Saskatchewan, Quebec, Newfoundland and Nova Scotia to permit the resale of BT Group Shares and BT Group ADSs by holders in each such province provided that, among other things, trades are made through the facilities of a stock exchange or other organised exchange facility outside Canada on which BT Group Shares and BT Group ADSs are listed or may be traded, in accordance with all rules and laws applicable to such stock exchange or other exchange facility and provided that the resale is made through a registered dealer in the relevant province. No assurance can be given that this relief will be forthcoming. BT Shareholders and holders of BT ADSs should consult their own professional advisers on such matters.

All of the directors and officers of the Company may be located outside Canada and, as a result, it may not be possible for Canadian holders of BT Shares to effect service of process within Canada upon the Company or such persons. All or a substantial portion of the assets of the Company may be located outside Canada and, as a result, it may not be possible to satisfy a judgement against the

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Company or such persons in Canada or to enforce a judgment obtained in Canadian courts against the Company or persons outside Canada.

### **(c) New Zealand**

The issue of BT Group Shares may be an offer under New Zealand securities laws and, therefore, New Zealand holders of BT Shares should note that:

- (i) the offer and issue of BT Group Shares is made in accordance with the laws of the United Kingdom;
- (ii) none of BT, the Company and mmO<sub>2</sub> plc may be subject to New Zealand law, and as a consequence, contracts in respect of BT Group Shares may not be enforceable in New Zealand courts; and
- (iii) this document is not a prospectus registered under New Zealand law and may not contain all the information that a New Zealand registered prospectus is required to contain.

### **(d) France**

This document has not been submitted for approval by the Commission des Opérations de Bourse in France and this document and the information contained herein may not be supplied to the public in France or used in connection with any offer of securities to the public in France.

## **5. BT Group ADSs**

This part contains further information for holders of BT ADSs. The dates given are based on BT's current expectations and may be subject to change.

### **Expected timetable of principal events for holders of BT ADSs**

2001

Documents mailed to holders of BT ADSs . . . . .	From 24 September
Latest time for holders of BT ADSs at the relevant record date to provide voting instructions to the ADS Depository for the Court Meeting and Extraordinary General Meeting . . . . .	18 October
Court Meeting and Extraordinary General Meeting . . . . .	3.00 p.m. New York Time
When issued trading in mmO <sub>2</sub> ADSs on the New York Stock Exchange expected to commence . . . . .	23 October
Court hearing of the petition to sanction the Scheme . . . . .	9 November 9.30 a.m. New York Time
Court hearing of the petition to confirm the reduction of capital of BT provided for under the Scheme. . . . .	14 November
Dealings in BT Shares on the London Stock Exchange ceases . . . . .	15 November
Trading in BT ADSs on the New York Stock Exchange ceases . . . . .	16 November
Scheme Record Time . . . . .	16 November 5.00 p.m. London Time
Scheme Effective Time . . . . .	16 November 5.30 p.m. London Time
Demerger Record Time . . . . .	16 November
Demerger Effective Time . . . . .	19 November 6.00 a.m. London Time
Dealings in BT Group Shares and mmO <sub>2</sub> Shares commences on London Stock Exchange. . . . .	19 November 8.00 a.m. London Time
Trading in BT Group ADSs and mmO <sub>2</sub> ADSs commences on the New York Stock Exchange . . . . .	19 November 9.30 a.m. New York Time
BT ADSs exchanged for BT Group ADSs and mmO <sub>2</sub> ADSs through DTC for book-entry holders of BT ADSs. . . . .	19/20 November
Notice mailed to registered holders of BT ADSs regarding the exchange of BT ADSs for BT Group ADSs and mmO <sub>2</sub> ADSs . . . . .	From 20 November
Court hearing of the petition to confirm the BT Group Reduction of Capital . . . . .	20 November
BT Group Reduction of Capital becomes effective . . . . .	21 November

### **(i) Information for holders of BT ADSs**

#### ***The Scheme and the Demerger***

Following the Scheme becoming effective the BT Shares underlying each BT ADS will be cancelled and an equal number of mmO<sub>2</sub> Shares will be issued to the ADS Depository. Following the Demerger becoming effective the ADS Depository, as the registered holder of mmO<sub>2</sub> Shares, will receive a distribution of BT Group Shares pursuant to the Demerger. The ADS Depository will receive one BT Group Share for each mmO<sub>2</sub> Share held at the Demerger Record Time.

Following the Scheme and Demerger becoming effective, the ADS Depository will request that all holders of BT ADSs as of 5.00 p.m. (New York Time) on 16 November 2001 exchange their existing BT ADSs for BT Group ADSs and mmO<sub>2</sub> ADSs. For each BT ADS held at this time, holders of BT ADSs will receive one BT Group ADS and one mmO<sub>2</sub> ADS.

Following the Scheme and the Demerger becoming effective, the ADS Depository will mail a notice to registered holders of BT ADSs regarding the mechanics of exchange of BT ADSs for BT Group ADSs and mmO<sub>2</sub> ADSs. Holders of registered BT ADSs will need to follow the instructions set out in this notice to exchange their BT ADSs for BT Group ADSs and mmO<sub>2</sub> ADSs. Following the Scheme and the Demerger becoming effective, with no action on the part of the holders of book-entry BT ADSs, appropriate notation will be made at the relevant book-entry facility with respect to the book-entry BT ADSs to credit such holders' accounts with the appropriate number of BT Group ADSs and mmO<sub>2</sub> ADSs.

After the Scheme and the Demerger are effective, an mmO<sub>2</sub> ADS facility will be created and the BT ADS facility will become a BT Group ADS facility.

## **(ii) Voting**

The latest time to provide the ADS Depository with voting instructions for both the Court Meeting and the EGM is 3.00 p.m. (New York time) on 18 October 2001.

Holders of BT ADSs will not, except as described below, be entitled to attend the Court Meeting or the EGM or to be present at the Court hearings to sanction the Scheme and to confirm the reduction of capital provided for under the Scheme, although the ADS Depository or its nominee as the record holder of BT Shares underlying the BT ADSs will be so entitled and will vote in accordance with instructions that may be received by 3.00 p.m. (New York time) on 18 October 2001 from holders of BT ADSs.

Holders of BT ADSs who wish to attend the Court Meeting or the EGM or to be present at the above mentioned court hearings to sanction the Scheme and to confirm the reduction of capital provided for under the Scheme should take steps to present their BT ADSs to the ADS Depository, as depository under the BT ADS Deposit Agreement, for cancellation and (upon compliance with the terms of the BT ADS Deposit Agreement, including payment of the ADS Depository's fee and any applicable taxes and governmental charges) delivery of BT Shares so as to become record holders of BT Shares prior to the relevant Voting Record Time for the Court Meeting or the EGM or prior to the relevant Court hearing, as the case may be. The relevant Voting Record Times for the Court Meeting and the EGM and the dates of the Court hearings, to sanction the Scheme and confirm the reduction of capital provided for under the Scheme, appear in the Expected Timetable of Principal Events at the beginning of this document.

Similarly, holders of BT ADSs who wish to be present at the Court hearing to consider the BT Group Reduction of Capital are advised to consider taking steps (as described in the paragraph above) to cancel their BT ADSs to become holders of BT Shares so that they will become, pursuant to the Scheme and the Demerger, shareholders in the Company. As shareholders in the Company they will have the right to attend the Court hearing on 20 November 2001 in person or be represented by counsel to support or approve the sanctioning of the BT Group Reduction of Capital.

## **(iii) New York Stock Exchange listing of BT Group ADSs and mmO<sub>2</sub> ADSs**

A supplemental listing application will be made to list the BT Group ADSs, each representing 10 BT Group Shares, on the New York Stock Exchange.

An original listing application will be made to list the mmO<sub>2</sub> ADSs, each representing 10 mmO<sub>2</sub> Shares, on the New York Stock Exchange.

Neither of the above listing applications are conditions to be satisfied for the Demerger to become effective.

## **6. Available information**

BT files annual and special reports and other information, with the SEC. After the Scheme and Demerger are effective, the Company and mmO<sub>2</sub> plc will file annual and special reports and other information, with the SEC. You may read and copy any reports and other information on file at the SEC's public reference room located at 450 Fifth Street, NW, Washington, D.C. 20549 or at one of the SEC's other reference rooms in New York and Chicago, Illinois. Please call the SEC at 1-800-SEC-0330 for more information on the public reference rooms. The SEC filings are also available to the public from commercial document retrieval services on payment of a fee.

The BT ADSs are listed on the New York Stock Exchange. It is currently anticipated that both the Company and mmO<sub>2</sub> plc will be listed on the New York Stock Exchange. You may inspect any reports and other information filed with the SEC by BT, the Company or mmO<sub>2</sub> plc at the offices of the New York Stock Exchange at 20 Broad Street, New York, New York 10005.

Following the Scheme becoming effective, mmO<sub>2</sub> Shares will be registered under the Securities Exchange Act and mmO<sub>2</sub> plc will be subject to the information requirements of the Securities Exchange Act and will be required to file reports and furnish other information with the SEC and the New York Stock Exchange. In addition, after the Demerger, BT Group Shares will be registered under the

## ***Part 2: Further information relating to the Scheme, the Demerger and the BT Group Reduction of Capital***

Securities Exchange Act and the Company, as the successor registrant to BT, will continue to be subject to the information requirements of the Securities Exchange Act and will continue to file reports and furnish other information with the SEC.

### **(i) Exemption from registration under the Securities Act**

#### ***The Scheme***

The mmO<sub>2</sub> Shares and the mmO<sub>2</sub> ADSs will not be registered under the Securities Act in reliance upon the exemption from the registration requirements of the Securities Act provided by Section 3(a)(10) of that Act. mmO<sub>2</sub> Shares and mmO<sub>2</sub> ADSs issued to a BT Shareholder or to a holder of BT ADSs who is neither an affiliate, for the purposes of the Securities Act, of BT prior to the Scheme Effective Time nor an affiliate of mmO<sub>2</sub> plc after the Scheme Effective Time, may be resold without restriction under the Securities Act. BT Shareholders and holders of BT ADSs who are affiliates of BT prior to the Scheme Effective Time or affiliates of mmO<sub>2</sub> plc after the Scheme Effective Time will be subject to certain restrictions under the Securities Act on the resale of any mmO<sub>2</sub> Shares and mmO<sub>2</sub> ADSs received by them under the Scheme, except for resale transactions otherwise exempt from the restrictions of the Securities Act. BT Shareholders and holders of BT ADSs who believe they may be affiliates for the purposes of the Securities Act should consult their own legal advisers prior to any sale of mmO<sub>2</sub> Shares or mmO<sub>2</sub> ADSs received upon implementation of the Scheme.

For the purpose of qualifying for the exemption from the registration requirements of the Securities Act, provided by Section 3(a)(10) of that Act, with respect to the mmO<sub>2</sub> Shares and the mmO<sub>2</sub> ADSs issued pursuant to the Scheme, BT will advise the Court that its sanctioning of the Scheme will be relied upon by BT as an approval of the Scheme following a hearing on its fairness to BT Shareholders at which hearing all such shareholders are entitled to attend in person or through counsel to support or oppose the sanctioning of the Scheme and with respect to which notification has been given to all such shareholders.

#### ***The Demerger***

BT Shareholders and holders of BT ADSs who are citizens or residents of the United States are advised that registration under the Securities Act of the BT Group Shares and BT Group ADSs to be distributed pursuant to the Demerger is not required.

## **7. Taxation**

Information relating to UK, US and Netherlands taxation is contained in paragraphs 1, 2 and 3 of Part 6, respectively. Shareholders who are in any doubt as to their tax position, or who are resident in any other jurisdiction, should consult a professional adviser immediately.

# Part 3: Financial review

## Introduction

The following discussion and analysis should be read in conjunction with the financial information included in Part 5 and the information on the BT Group included elsewhere in this document.

Comparative financial information is presented in Part 5 of these listing particulars extracted from BT's audited annual financial statements for the years ended 31 March 1999, 2000 and 2001 without material adjustment except for the restatement of earnings, loss and dividend per share as discussed below. Two columns analysing the historical BT results between those of BT Group and discontinued businesses comprising mmO<sub>2</sub>, Yell and the former investments in Japan and in Airtel in Spain have been added to the profit and loss account statements for those years.

The financial review concentrates on the operating performance of BT Group for the last three completed financial years. Since it is not in general meaningful to discuss net interest and tax charges, cash flows, financing and balance sheet items divided between BT Group and discontinued businesses, these items have been covered in the review in the context of BT as a whole, unless otherwise stated. Earnings and dividends per share figures in the review and in the comparative tables have been restated to reflect the dilutionary impact of the Rights Issue which closed on 15 June 2001 since BT's latest audited financial statements were approved before this date.

Information, including a commentary, on BT's results for the three months ended 30 June 2001 is set out in Part 4 of this document; earnings per share figures are also shown after making the adjustment for the dilutionary impact of the Rights Issue of around 11 per cent. Since BT's annual financial statements were approved, some changes have been made to the basis of charges between lines of business and in the current financial year BT has adopted FRS 19, the new financial reporting standard on deferred tax. Consequently, several restatements have been made to comparative figures in the information on the quarter's results. The comparative tables in Part 5 of this document have not been amended for the adoption of FRS 19 nor for the changes in the basis of inter-business charging.

## Summary of results

BT Group's earnings of 21.6 pence per share for the year ended 31 March 2001 (the 2001 financial year) compares with earnings of 29.7 pence for the 2000 financial year and 40.4 pence for the 1999 financial year. Exceptional items and goodwill amortisation affected earnings in each of these years. Earnings for the 2001 financial year were affected by net exceptional credits of 3.8 pence per share, primarily relating to profit on disposals of investments and rates refunds partially offset by goodwill impairment. Of the earnings in the 2000 financial year, 0.6 pence per share represented net exceptional income. In the 1999 financial year, net exceptional income amounted to 10.3 pence per share mainly relating to the sale of the group's investment in MCI Communications Corporation in September 1998. Goodwill amortisation adversely affected earnings by 2.2 pence in the 2001 financial year before exceptional charges, 0.9 pence in the 2000 financial year and by 0.1 pence in the 1999 financial year. Before goodwill amortisation and exceptional items, earnings of 20.0 pence per share for the 2001 financial year compare with an equivalent 30.0 pence and 30.2 pence for the 2000 and 1999 financial years respectively.

The results for the 2001 financial year reflect the higher interest charges which have arisen from the financing of BT's investment in new businesses, including those of mmO<sub>2</sub>, as well as the adverse effect which competitive pressures have had on BT's operating margins in the UK fixed-voice telephony market. On the Demerger, BT Group is retaining substantially all of the resulting indebtedness. The results for the 2000 financial year also reflected the adverse effect which competitive pressures had on operating margins. The results for that year were additionally impacted by the costs of meeting increased customer demand and of growing new areas of business. In both the 2001 and 2000 financial years, BT benefited from the strong growth in demand for the group's products and services. Internet usage expanded rapidly and this led to increased turnover. In the 2000 financial year, the buoyant UK economy had a beneficial effect on the results. BT's ventures in North America and continental Europe which had been established, or in which BT had acquired interests, in recent years, contributed significantly to its total turnover growth. However, the initial losses incurred by many in their development stages are, as anticipated, adversely affecting the group's results. BT continues to be affected by the tight regulatory regime in the UK. Price reductions, including those imposed by the price control formulae, totalled approximately £210 million in the 2001 financial year, following reductions of approximately £510 million in the 2000 financial year and over £360 million in the 1999 financial year.

The 2001 financial year was dominated by the restructuring of what was previously a centrally organised business into several decentralised lines of business, by acquisitions of interests and mobile licences in Europe and by the consequent increase in net debt, which rose to £27.9 billion at 31 March 2001. Towards the end of the 2001 financial year, in January and February 2001, BT

## **Part 3: Financial review**

acquired the 55 per cent. interest in Viag Interkom of Germany it did not already own. Earlier in the year, in June 2000, BT also acquired the 50 per cent. interest in Telfort of The Netherlands not already owned.

During the year, BT acquired through auctions one of the five UK third-generation mobile licences, Viag Interkom gained one of six licences in Germany and Telfort acquired one in The Netherlands. BT also acquired a significant economic interest in the J-Phone mobile businesses in Japan in May 2000 which was sold in June 2001 to Vodafone. In order to finance these investments, BT issued two significant series of bonds totalling £13 billion, one primarily in the US and the other primarily in Europe. In November 2000, BT sold its 34 per cent. interest in sunrise communications at a profit of £454 million.

In early January 2000, Concert, BT Group's global venture 50:50 owned with AT&T, was established. Concert took over a major part of BT Group's international communications activities and is currently managing the communication needs of a number of BT's multinational corporate customers. At the same time, it also acquired the Concert Communications Services group (Concert Communications) from BT Group. As a consequence, from the last quarter of the 2000 financial year, certain of the group's former turnover is reported as part of BT Group's proportionate share of the joint venture's turnover. BT is continuing discussions with AT&T concerning the future of the Concert joint venture. This is dealt with in more detail in paragraph 4 of Part 1 of this document. Also in the 2000 financial year, BT took a 30 per cent. interest, jointly with AT&T, in Japan Telecom, acquired the remaining 40 per cent. interest in BT Cellnet which it did not already own, and acquired control of Esat Telecom Group, a leading Irish communications group. The AT&T ownership interest in Japan Telecom was acquired by Vodafone in April 2001 and in June 2001 BT sold its interest in Japan Telecom also to that company.

In the 1999 financial year, BT's interest in MCI, held since 1994, was sold on the completion of the MCI/WorldCom merger. BT recognised a pre-tax profit of £1,133 million on this sale. At the same time as BT disposed of its interest in MCI in September 1998, it acquired the minority interest owned by MCI in Concert Communications.

Subsequent to 31 March 2001, BT has completed several major steps in reducing its net debt of £27.9 billion at that date to £17.5 billion at 30 June 2001. These steps have comprised the raising of £5.9 billion from shareholders through the Rights Issue which closed in June 2001, and, in the same month, the sale of BT's interests in Japan and in Airtel in Spain for £4.8 billion and the sale of Yell, the classified advertising directories business, for approximately £2 billion. The Board now expects to reduce net debt to between £15 billion and £17 billion for the BT Group at 31 March 2002 on the assumption that BT's property sale and leaseback transaction has been completed which is expected to raise approximately £2.3 billion.

### **Regulation and prices**

BT Group has been operating under the existing retail price control from 1 August 1997, under which a cap of RPI minus 4.5 applies to the services used by the lowest 80 per cent. of BT Group's residential customers by bill size. This retail price control is estimated to have covered services representing about 13 per cent. of the group's turnover for the 2001 financial year. In the price control year to 31 July 2001, BT Group has reduced its prices by 1.20 per cent., which was more than the required reduction of 1.09 per cent. The equivalent reduction in the previous control year was 3.24 per cent.

BT Group's interconnect (network) charges to other UK operators are based on long-run incremental costs. There have been annual reductions in these charges based on a RPI minus 8 price cap. The current network charge control regime operates until 30 September 2001. From 1 October 2001, the broad structure of the interconnect (network) services is to be retained for a further four years, but the "X" within the RPI minus X price-cap formula is to be varied between 7.5 and 13.

The Competition Commission (CC) required BT Group to reduce charges from a BT Group line to mobile phones by around 25 per cent. in the 1999 financial year and an effective annual RPI minus 7 reduction for the 2000 and 2001 financial years. This is now extended to 31 July 2002.

The regulatory environment in the UK has had, and will continue to have, a significant adverse impact on the group's turnover and operating profit. As the group has extended its activities to other countries, BT Group is required to consider the regulatory regimes in those countries.

### **Competition and the UK economy**

BT Group has a significant market share in its main UK markets for fixed-network calls and provision of exchange lines. Competition has eroded BT Group's market share significantly in key market sectors, in particular areas of the UK and for certain products and services. BT Group estimates that it had 57 per cent. of the market for national calls in the 2001 financial year, compared with 64 per cent. and 69 per cent. in the 2000 and 1999 financial years, respectively, and supplied 83 per cent. of the



exchange lines in the UK at 31 March 2001, compared with 84 per cent. and 86 per cent. at 31 March 2000 and 1999, respectively. Additionally, BT Group estimates that it had 71 per cent. of the market for local calls in the 2000 financial year, compared with 74 per cent. and 78 per cent. in the 2000 and 1999 financial years, respectively.

The growth in cable operators' networks in the UK is having an adverse effect on BT Group's share of the residential market. In recent years, BT Group has experienced a small net annual reduction in residential exchange line connections as a result of increasing competition from these cable operators in certain geographic areas. This small rate of reduction is expected to continue. BT Group has also seen some diversion of demand from its fixed-network as a result of the growth of other licensed operators' activities. This diversion may intensify now that BT's fixed-line customers are able to pre-select their carrier.

Additionally, BT Group's Licence was amended in April 2000 to require BT Group to provide other operators with use of the lines connecting BT Group's local exchanges to its customers and allow operators to install equipment in BT Group's exchanges (local loop unbundling). This amendment took effect in December 2000. This could result in further intensification of competition and have an adverse effect on BT Group's results.

For its operations as a whole, BT Group expects the competitive pressure to persist and it will continue to defend its market share vigorously and fairly.

The strength of the UK economy is an important determinant of BT Group's business volumes and the gross domestic product grew by 2.5 per cent. in the 2001 financial year, compared with 2.9 per cent. and 1.5 per cent. in the 2000 and 1999 financial years, respectively.

## Lines of business results

In the following commentary, the operations of the BT Group for the 2001 financial year are discussed in terms of its lines of business established during the 2001 financial year. However, as it is not practical to compile comparative figures for the 2000 and 1999 financial years for these lines of business, these two earlier years are discussed in general terms in the context of the relevant line of business. Since BT's annual financial statements were approved, some changes have been made to the basis of charges between lines of business. The discussion in this review reflects lines of business results determined on its basis of charges in effect at the end of the 2001 financial year.

The BT Group's profits are derived predominantly from BT Retail and BT Wholesale's fixed-network business in the UK. BT Ignite and BTOpenworld are both in a development stage incurring losses.

## Turnover

Group turnover for BT Group excluding its share of the ventures' turnover, grew by 6.2 per cent. to £17,130 million in the 2001 financial year after growing by 6.1 per cent. in the 2000 financial year compared with the 1999 financial year. The principal areas of growth were through the acquisition of interests in Europe and from interconnect with other UK operators. Acquisitions made in the 2001 and 2000 financial years contributed approximately £400 million to the growth in turnover in the 2001 financial year. The transfer of certain BT Group businesses to the Concert global venture in January 2000 had the effect of reducing group turnover by approximately £610 million. In the 2000 financial year, acquisitions in the 2000 and 1999 financial years contributed about £145 million of the growth in group turnover. Both fixed-network to mobile calls and interconnect receipts in the UK made strong contributions to the growth in group turnover in the 2000 financial year, as a result of the significant growth in the UK mobile operators' customer bases and increased mobile usage.

## BT Retail

BT Retail's turnover is mainly derived from BT Group's UK fixed-network customers through the provision of fixed-network call services, exchange lines and private services.

Turnover from fixed-network calls declined by 4.3 per cent. to £5,655 million in the 2001 financial year following a decline of 2.0 per cent. in the 2000 financial year compared with the 1999 financial year. Fixed-network calls comprise all calls by customers made from fixed lines in the UK, including outbound international calls. In both the 2001 and 2000 financial years, call volume growth was more than offset by the effect of significant price reductions.

Price reductions had an impact on turnover from fixed-network calls for all the years under review. In the 2001 financial year, the principal reductions were in the prices for most types of geographic calls. In the 2000 financial year, the principal reduction was the 25 per cent. cut in fixed to mobile call prices from the end of April 1999 as required by the Competition Commission. Other

## **Part 3: Financial review**

reductions included enhanced discounts and lower Freephone and Lo-call prices charged to other service providers. The combined effect of the price changes to fixed-network calls totalled approximately £280 million in the 2001 financial year, which was equivalent to a 5 per cent. reduction in call prices following falls of 9 per cent. and 3 per cent. in the previous two years.

The main volume growth in fixed-network calls in the 2001 financial year was derived from a significant increase in calls to mobile phones and the increased use of the internet. In the 2000 financial year, similar factors were also behind the increase in calls over BT Group's fixed-network. The call volume growth of 2 per cent. in the 2001 financial year compares with 7 per cent. in the 2000 financial year. While fixed to mobile and internet-related local calls continued to grow strongly, traditional geographic fixed-network calls declined in volume, which BT Group attributes partly to mobile phone substitution and also to intense competition. Call volume growth on a 12 month moving average basis reduced to 1 per cent. to 30 June 2001 and call volumes may decline in the second half of the 2002 financial year on an annualised basis, as the growth in fixed to mobile calls weakens.

Turnover from exchange lines grew by 4.2 per cent. in the 2001 financial year to £3,674 million after increasing by 5.2 per cent. in the 2000 financial year. The increased turnover was the combined result of the growth in business lines and rental price increases. The number of business lines grew by 5.4 per cent. in the 2001 financial year and by 5.9 per cent. in the 2000 financial year, with ISDN services being the main driver behind this growth. The numbers of residential lines declined slightly in both years due to the competition from other fixed line providers largely offset by the high number of BT customers installing second lines. Overall, BT Group's total fixed-network lines grew by 1.3 per cent. in the 2001 financial year to 28.95 million and by 1.9 per cent. in the 2000 financial year to 28.58 million.

Private services turnover decreased by 3.9 per cent. in the 2001 financial year to £1,091 million, following a decline of 0.4 per cent. in the previous financial year. The decline in both years was mainly attributable to the transfer of activities to the Concert global venture in January 2000.

On the basis of its 2001 financial year inter-business charging arrangements, BT Retail achieved an operating profit of £1,004 million, before exceptional items, in the 2001 financial year on turnover of £11,813 million. Margins for the year were affected by the adverse mix effect of the increase in calls from fixed to mobile and the internet, with declines in geographic calls, although the rate of decline in geographic calls reduced in the last quarter of the year. BT Group believes that this is linked to the success of the new BT Together family of products.

### **BT Wholesale**

The majority of BT Wholesale's turnover is derived from supplying network services to BT Retail. Its external turnover is derived from receipts from other network operators and service providers for interconnect and other services.

Turnover from receipts from other operators for interconnect charges increased by 39 per cent. in the 2000 financial year and by 43 per cent. to £2,814 million in the 2001 financial year. This turnover mainly comprises the income BT Group generates from other UK operators for passing calls from one operator to another and for terminating calls on BT Group's network. In the 1999 and 2000 financial years, it also included receipts from international operators for incoming international and transit calls which BT Group received before this activity was transferred to Concert in early January 2000. From that date, this turnover includes receipts from Concert for terminating incoming calls into the UK and handling Concert's UK multinational customer domestic traffic. The increases in turnover, in the 2001 and 2000 financial years, primarily reflect the growing market share of BT Group's UK competitors, particularly mobile phone operators, and the increasing level of traffic flowing through and into BT Group from their networks. There has been a large corresponding increase in the payments made by BT Group to these operators for traffic passing to their networks. Although growth has been rapid, with volumes growing at 39 per cent. for the 2001 financial year, and 38 per cent. for the 2000 financial year, BT Group's interconnect business does not provide the group with the same overall level of margin as its UK retail business.

On the basis of its 2001 financial year inter-business charging arrangements, BT Wholesale contributed an operating profit before exceptional items of £2,540 million on turnover of £11,493 million, in the 2001 financial year. Externally generated turnover amounted to slightly over £3 billion for the year. BT Wholesale has the responsibility for wholesale broadband products and the losses for this activity are included in the results. Return on capital employed was 20 per cent.

### **BT Ignite**

BT Ignite's group turnover in the 2001 financial year was £3,470 million with an operating loss of £380 million before goodwill amortisation and exceptional items. The main driver of operating losses for BT Ignite is from investments in BT's new value

added businesses, amounting to £358 million in the year. These include £115 million in the year for content hosting and application service provision. The operating losses generated by fixed operations consolidated for the first time in this financial year, including Esat, Telfort and Viag Interkom, amounted to a total of £135 million.

### **BTopenworld**

BTopenworld incurred an operating loss of £296 million on turnover of £212 million in the 2001 financial year. Its turnover is derived principally from its UK narrowband internet access products. Narrowband activities contributed approximately 50 per cent. of the operating loss whilst our broadband services make up around 40 per cent. reflecting the start-up nature of the businesses.

### **Other operating income**

As part of the arrangements for the establishment of Concert, BT Group has been seconding staff and providing administrative and other services from its launch in early January 2000. The income from these services totalled £168 million in the 2001 financial year and £79 million in the 2000 financial year.

### **Operating costs**

Total operating costs of the BT Group increased by 11.7 per cent. in the 2001 financial year to £14,500 million after increasing by 9.0 per cent. in the 2000 financial year. As a percentage of group turnover, operating costs, excluding goodwill amortisation, increased from 78 per cent. in the 1999 financial year to 80 per cent. in the 2000 financial year and to 83 per cent. in the 2001 financial year.

Staff costs increased by 2.4 per cent. in the 2001 financial year to £4,066 million, after rising by 8.0 per cent. in the 2000 financial year. In the 2001 financial year, the numbers employed in the continuing BT Group reduced by 10,100 to 115,300 at 31 March 2001. Over 5,800 people left the group on voluntary release and other incentive terms and some 3,000 people transferred to joint ventures. Higher pension costs and the annual pay awards were the main reasons for the increase in staff costs. In the 2000 financial year, the numbers employed in the continuing BT Group increased by 8,500. This net increase included 3,200 individuals employed outside the UK mainly through acquisitions, 2,500 former agency workers now working for BT Group, and around 4,500 people needed in the UK to meet increased demand and to roll out the ADSL broadband product. These increases and the impact of pay awards caused the increase in staff costs in the 2000 financial year.

The depreciation charge increased by 8.6 per cent. in the 2001 financial year to £2,668 million after increasing by 3.5 per cent. in the 2000 financial year, reflecting BT Group's continuing high level of investment in its networks and, in the 2001 financial year, the acquisition of its new businesses.

Payments to other telecommunication operators, excluding mmO<sub>2</sub>, grew by 23 per cent. in the 2001 financial year to £3,701 million after increasing by 32 per cent. in the 2000 financial year. The growth in these payments was primarily as a result of the growing number of calls originating on or passing through BT Group's networks and terminating on UK competitors' fixed and mobile networks. This is due, in particular, to the increase in mobile phone usage and internet-related calls. The payments include those made to Concert for the delivery of BT Group's outgoing international calls from early January 2000 and those made by BT Group to international operators for outgoing and transit calls prior to that time.

BT Group's other operating costs, which rose by 10 per cent. in the 2001 financial year to £4,426 million and by 0.4 per cent. in the 2000 financial year, include the maintenance and support of the networks, accommodation and marketing costs, the cost of sales of customer premises equipment and redundancy costs. The increase in costs in the 2001 financial year is mainly attributable to the other operating costs of acquired businesses. In the 1999 financial year, a currency gain of £87 million from investing the proceeds of the MCI shares was offset against these costs.

Redundancy costs of £104 million were incurred in the 2001 financial year, compared with £59 million in the 2000 financial year and £124 million in the 1999 financial year. The redundancy costs in the 2001 financial year and to a much lesser extent in the 2000 financial year include the costs of over 3,000 managers who took early voluntary release as part of BT's plans to improve efficiency. In view of a pension fund surplus, which for accounting purposes includes the provision for pension costs in the group's balance sheet, and in accordance with BT's accounting policies, redundancy charges for the three financial years 2001, 2000 and 1999 do not include the costs of the incremental pension benefits provided to early retirees, which totalled £429 million, £140 million and £279 million, respectively.

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The arrangements under which people leave BT in advance of the normal retirement age have been modified. Under the NewStart programme launched during the fourth quarter of the 2001 financial year, BT employees are expected to leave with a leaving payment in place of a redundancy payment, and incremental pension benefits are being scaled down. This should reduce early leaver costs, which have been very significant in recent years.

The most significant exceptional item within BT's operating costs in the 2001 financial year is the impairment of goodwill in Viag Interkom. The acquisition of the 55 per cent. interest in the company, including its wireless business, for £8,770 million was completed in January and February 2001 including repayment of loans. Goodwill of £4,992 million arose on this transaction, the consideration for which was negotiated in August 2000. An impairment review was undertaken under the requirements of the UK Accounting Standard FRS 11, incorporating reduced expectations for the rate of growth in profits in the medium term reflecting current market views. An impairment in goodwill of £3,000 million resulted from this review in respect of Viag Interkom of which £200 million is related to its fixed business in BT Group.

Other exceptional items within operating costs in the 2001 financial year mainly comprised:

- a write off of £43 million on Viag Interkom's IT systems following its division into fixed and wireless business on BT's acquisition, of which £22 million related to its fixed business; and
- a credit of £193 million for the refund of rates on BT Group's infrastructure following a successful legal action taken by BT Group in 2000 to challenge the rateable valuations on which it was charged for its network assets.

In the 2000 and 1999 financial years, costs of £64 million and £69 million, respectively, involved in the work to ensure that BT Group's business became fully independent of MCI have been shown as exceptional items in the group profit and loss account.

In the 2002 financial year productivity improvements and cost savings are being sought and initiatives to reduce costs totalling approximately £575 million have been identified.

### Group operating profit

Group operating profit for the BT Group for the 2001 financial year of £3,023 million was £359 million lower than in the previous year. The profit for the 2000 financial year was £73 million lower than in the 1999 financial year. Before goodwill amortisation and the exceptional items described above, group operating profit in the 2001 financial year was 9.3 per cent. lower than in the 2000 financial year. This, in turn, was 1.9 per cent. lower than that in the 1999 financial year. The reduction in profit in the 2001 financial year was caused by reduced call prices, increased lower margin wholesale business with other operators, the losses of £108 million incurred by BT Group's newly-acquired businesses and higher redundancy costs. The reduction in profit in the 2000 financial year was also caused by reduced call prices and increased lower margin wholesale business with other operators, as well as the cost of developing new products and areas of business and increased expenditure on improving the quality of service to our customers. The factors experienced in the 2001 financial year are expected to continue.

### Associates and joint ventures

BT Group's share of its continuing ventures' turnover rose from £989 million in the 1999 financial year to £2,279 million in the 2000 financial year and to £4,631 million in the 2001 financial year, including sales by the principal venture to BT Group. This growth was due to the establishment and acquisition of interests in ventures in North America, Europe and Asia Pacific over the past three years. Acquisitions of interests contributed £2,818 million of the growth in the 2001 financial year and £726 million of the growth in the 2000 financial year. In the 2001 financial year, £4,567 million of the total arose from ventures located outside the UK, compared with £2,266 million in the 2000 financial year and £986 million in the 1999 financial year. The principal contributors in the 2001 financial year were Concert (£2,576 million), Cegetel (£860 million), Viag Interkom (£179 million to February 2001) and LG Telecom (£281 million). The main contributors in the 2000 financial year were Cegetel (£727 million), Concert (£583 million from January 2000), Viag Interkom (£185 million) and a full year's contribution from LG Telecom (£200 million). In the 1999 financial year, the main contributors were Cegetel (£578 million), Viag Interkom (£81 million) and LG Telecom (£81 million from October 1998).

BT Group's share of its ventures' operating losses totalled £254 million in the 2001 financial year, before £278 million goodwill amortisation and impairment. The results included an exceptional write off of £96 million for subscriber acquisition costs. The comparable losses, before goodwill amortisation, amounted to £156 million in the 2000 financial year and £204 million in the 1999 financial year.

Losses in all three years arose in Viag Interkom, before it became a wholly-owned subsidiary in February 2001, in developing its networks to compete in the German market. BT Group's share of its fixed-network losses was £28 million (for 11 months), £23 million

and £91 million in the 2001, 2000 and 1999 financial years, respectively. Telfort also incurred losses in every year before it became a wholly-owned subsidiary in June 2000, as it had been developing its networks in The Netherlands. In the 2001 financial year, other losses were mainly incurred by Blu and Albacom in Italy and British Interactive Broadcasting (BIB) in the UK until BT Group's interest was diluted in summer 2000. Ventures returning operating profits in the 2001 financial year mainly comprised Concert, Cegetel in France and Maxis Communications in Malaysia. BT Group has agreed to sell its interest in Maxis and sold its interest in BIB in June 2001.

Concert's operating profit before goodwill amortisation and exceptional items attributable to BT Group was £19 million for the 2001 financial year on its share of turnover of £2,576 million. Concert's performance deteriorated as the year progressed and, in the final quarter, it moved into losses for the first time. These losses are continuing. Concert's performance was impacted by bad debt provisions as its customers have weakened financially, along with depreciation from increased investment in cable systems. The competitive pressure on margins is continuing and management action is being taken to improve the performance of the business. The new management of Concert have already taken action, including the reduction of headcount. As currently structured, losses are likely to be significant in the 2002 financial year.

In the 2000 financial year, losses, other than those already noted, were mainly incurred by BIB and Albacom. Ventures returning operating profits in the 2000 financial year included Concert, Cegetel and Maxis Communications. In the 1999 financial year, the other losses were incurred by Albacom, BIB and LG Telecom in the Republic of Korea, which has been a BT Group joint venture since October 1998.

Goodwill amortisation has been increasing as a result of new acquisitions in ventures. In the 2001 financial year, the BT Group charge totalled £78 million compared with £57 million in the 2000 financial year and £10 million in the 1999 financial year, which was the first year in which BT adopted FRS 10. This trend is not expected to continue since BT Group has not made any major acquisitions of interests in ventures since May 2000. Goodwill arising in Asian ventures has been considered to have become impaired during the 2001 financial year, and as such BT Group has incurred an exceptional impairment charge of £200 million.

BT is continuing discussions with AT&T concerning the future of the Concert joint venture. This is dealt with in more detail in paragraph 4 of Part 1 of this document. In the event that an unwinding of the Concert joint venture is agreed, and depending on the way that it is implemented, the financial effects on the BT Group are likely to include cash and non-cash restructuring costs which could be substantial. In addition, impairment charges are expected in BT Group's half year results to 30 September 2001 in respect of certain other investments, including AT&T Canada, totalling approximately £500 million.

### **Total operating profit**

Total operating profit of BT Group for the 2001 financial year was £2,491 million, including BT Group's share of the operating results of its ventures. This was a decrease of £678 million compared with the operating profit in the 2000 financial year. The profit for the 2000 financial year had decreased by £72 million over the 1999 financial year. Before goodwill amortisation and exceptional items, total operating profit for the 2001 financial year was 9.8 per cent. lower than in the previous financial year, which was virtually unchanged on the result for the 1999 financial year. The decline in the underlying total operating profit in the 2001 financial year was due to the factors explained above.

### **Profit on sale of group undertakings and fixed asset investments**

BT Group sold its 34 per cent. interest in sunrise communications of Switzerland to another joint venture partner in November 2000 for £464 million, realising a profit of £454 million. This is the main element in the total profit from disposals of group undertakings and fixed asset investments of £619 million in the 2001 financial year. Other profits during the year were principally derived from the disposal of certain of aeronautical and maritime interests, the sale of an interest in I.Net by way of a public offering, the reduction of an equity interest in BIB to below 20 per cent. and the sale of minor equity investments.

Following the completion of the MCI/WorldCom merger in September 1998, BT Group sold its holding in MCI to WorldCom under the agreement made in November 1997. The proceeds totalled £4,159 million on which an exceptional profit of £1,133 million was realised in the 1999 financial year, after taking into account the goodwill written off on BT Group's interest in MCI, originally acquired in September 1994.

### **Interest charge**

In the 2001 financial year, the total net interest charge, including BT's share of its ventures' charges, at £1,314 million was £932 million higher than in the preceding year, which in turn was £96 million higher than in the 1999 financial year. Of the total charge,

## Part 3: Financial review

£1,044 million arises in BT for the 2001 financial year, compared with £306 million and £261 million in the 2000 and 1999 financial years, respectively.

The total net interest charge attributed to BT Group is £1,034 million compared with £331 million in the 2000 financial year and £261 million in the 1999 financial year.

For the purposes of analysing BT's net interest charge between BT Group and discontinued operations in the comparative tables, interest on borrowings attributable to the financing of mmO<sub>2</sub>'s operations and acquisitions has not been allocated to that business. This is because, on the demerger, the BT Group will continue to hold and service the vast majority of BT's debt outstanding at the time of the demerger. BT's net debt outstanding at 30 June 2001 stood at £17.5 billion.

The substantially higher charge in the 2001 financial year is due to the cost of funding the third-generation mobile licences, principally in the UK and Germany, and the cost of acquisitions in the 2001 and 2000 financial years, including the BT Cellnet minority interests, the Esat group, Telfort and Viag Interkom. The group's net interest charge benefited in the year by an exceptional interest receipt of £25 million relating to the rates refund from the UK Government, noted above.

The higher total interest charge in the 2000 financial year over the previous year was mainly due to the cost of funding the acquisitions made by BT during the 2000 financial year, including the BT Cellnet minority acquisition.

BT's interest cover for the 2001 financial year represented 2.6 times total operating profit before goodwill amortisation and impairment, and compares with interest cover of 8.8 in the 2000 financial year and 12.2 in the 1999 financial year. The decline in cover is due to the substantial increase in the interest charge compared with a relatively static operating profit before goodwill amortisation and impairment. The net interest charge is expected to further increase and interest cover to decline in the 2002 financial year following the significant increase in net debt during the 2001 financial year offset in part by the proceeds of the Rights Issue and sales of investments in the current financial year.

### Profit (loss) and taxation

The group's loss before taxation for the 2001 financial year was £1,031 million, compared with profits of £2,942 million in the 2000 financial year and £4,295 million in the 1999 financial year. The loss in the 2001 financial year was principally due to the £3,200 million exceptional goodwill impairment charges discussed above. The substantially higher profit in the 1999 financial year was largely due to the gain on the MCI shares sold. After the allocation of the BT Group interest charge explained above, the BT Group profit before tax was £2,076 million in the 2001 financial year compared with £2,964 million in the 2000 financial year and £4,087 million in the 1999 financial year. Before goodwill and exceptional items, the BT Group profit before tax was £1,916 million in the 2001 financial year which was 35 per cent. below the comparable profit for the 2000 financial year which, was 2.9 per cent. above that for the 1999 financial year. The significantly lower underlying profit in the 2001 financial year was chiefly due to the lower opening profit and higher interest charges, explained above.

Tax relief is not available against the £3,200 million goodwill impairment charges, and the tax charge of £652 million for the 2001 financial year represents 30.1 per cent. of profit before taxation and goodwill impairment. This compares with a tax charge of 30.5 per cent. for the 2000 financial year and 30.1 per cent. for the 1999 financial year. The 2001 and 2000 effective tax rates compare with the standard 30 per cent. corporation tax rate for those years. The effective tax rate for the 2001 financial year has been adversely affected by the higher goodwill amortisation charges in the year which are not allowable expenses for tax purposes, partially offset by the gain on the sale of the investment in sunrise communications which is effectively subject to a lower tax charge. The group's tax charge for the 1999 financial year was an effective 31.0 per cent. of pre-tax profit. The MCI share sale gain was effectively subject to a lower tax charge under UK capital gains tax legislation. This effective tax charge reflects the higher 31 per cent. rate of corporation tax set for the 1999 financial year.

BT Group's allocation of the tax charge is £508 million for the 2001 financial year compared with £827 million for the 2000 financial year and £1,197 million for the 1999 financial year.

The minority interests in the results of the 2001 financial year of £127 million are primarily attributable to outside interests in the Japanese investments.

### Earnings (loss) and dividends

BT's basic loss per share, based on the loss for the 2001 financial year of £1,810 million, was 24.9 pence. Earnings per share for the 2000 and 1999 financial years were 28.4 pence and 41.5 pence, respectively. Earnings before goodwill amortisation and exceptional items

were 18.4 pence per share for the 2001 financial year, in comparison with 30.7 pence for the 2000 financial year and 31.4 pence for the 1999 financial year. Diluted earnings per share are not materially different.

BT Group earnings per share were 21.6 pence in the 2001 financial year compared with 29.7 pence in the 2000 financial year and 40.4 pence in the 1999 financial year. Earnings before goodwill amortisation and exceptional items were 20.0 pence, 30.0 pence and 30.2 pence per share in the 2001, 2000 and 1999 financial years, respectively.

BT paid or recommended dividends of 19.6 pence per share for the 2000 financial year and dividends of 18.3 pence per share in respect of the 1999 financial year.

The dividend for the 2001 financial year of 7.8 pence per share comprised the interim dividend paid in February 2001 which absorbed £571 million. As part of BT's debt reduction and restructuring plans, the board decided that there would be no final dividend in respect of the 2001 financial year and that there will be no interim dividend declared for the 2002 financial year. The Board expects to recommend a final dividend for BT Group in respect of the year ending 31 March 2002 and resume regular dividend payments thereafter. However, the level of dividends which the BT Group expects to pay is likely to be substantially lower than that paid by BT previously.

## Financing

Net cash inflow from BT's operating activities of £5,887 million in the 2001 financial year compared with £5,849 million in the 2000 financial year and £6,035 million in the 1999 financial year. Special and deficiency contributions to the main pension fund, described below, of £300 million in the 2001 financial year, £230 million in the 2000 financial year and £200 million in the 1999 financial year were paid, consequently reducing the cash inflow in those years.

Tax paid in the 2001 financial year totalled £669 million compared with £1,311 million paid in the 2000 financial year. The lower tax paid in the 2001 financial year was due to the lower profits earned in the 2001 and 2000 financial years compared with the 1999 financial year. The payments in the 2001 and 2000 financial years included the first quarterly instalments under the new corporation tax regime in the UK. Tax paid in the 1999 financial year, which totalled £630 million, included the second and final windfall tax instalment of £255 million which had been levied by the UK Government on privatised companies in the 1998 financial year. Less UK corporation tax was paid in the 1999 financial year than in the two succeeding years because the advance corporation tax (ACT) on a special dividend paid in September 1997 was able to be offset. The tax paid in the 1998 financial year had included £561 million ACT paid in respect of the special dividend.

The UK Government changed the pattern of corporation tax payments from April 1999 by requiring companies to pay tax in quarterly instalments starting at the half-year stage in each financial year. The changes are being phased in over the 2000 to 2002 financial years, and replace the former main single corporation tax payment made nine months after the financial year end and ACT payments associated with dividends.

Net cash outflow of £8,442 million for capital expenditure and financial investment in the 2001 financial year was principally for capital expenditure on plant and equipment of £4,756 million and £4,208 million invested in third-generation mobile licences. The net cash outflow of £3,752 million in the 2000 financial year was principally for capital expenditure on plant and equipment. In the 1999 financial year, there was a net cash inflow of £1,046 million which mainly comprised the £4,159 million proceeds of the MCI shares sold in September 1998 offset by expenditure on plant, equipment and property totalling £3,220 million.

Net cash outflow on acquisitions totalled £13,754 million in the 2001 financial year. This included £11,438 million invested in Viag Interkom, including acquisition of its licences, £1,233 million in Telfort, £1,176 million in completing the Esat Telecom Group acquisitions, offset by £464 million received on the disposal of sunrise communications and from other divestments. The net cash outflow on acquisitions of £6,405 million in the 2000 financial year was principally £3,014 million on the acquisition of the minority interest in BT Cellnet, £1,254 million invested jointly with AT&T in Japan Telecom and £659 million in Canadian interests, jointly owned with AT&T. The net cash outflow on acquisitions of £1,967 million in the 1999 financial year mainly resulted from the acquisition of MCI's minority interest in Concert Communications and the investments in LG Telecom and Maxis Communications, as well as additional funding of BT's European ventures. Consideration of £856 million for the completion of the Esat Digifone minority acquisition was paid in early April 2001.

Equity dividends paid in the 2001 financial year totalled £1,432 million, compared with £1,364 million in the 2000 financial year and £1,186 million in the 1999 financial year. As explained above, BT Group does not intend to pay any equity dividends in the 2002 financial year.

## Part 3: Financial review

The resulting cash outflow, before liquid resources and financing, of £19,127 million for the 2001 financial year was funded by BT issuing substantial amounts of long-term debt instruments and drawing on its medium-term notes programmes. In December 2000, BT raised £6,909 million through the issue of four series of US dollar notes totalling \$10 billion, with maturities between three and thirty years. In February 2001, BT received £6,038 million through the issue of six series of euro and sterling notes totalling €9.7 billion, with maturities between two and sixteen years. In April 2000, the BT Group issued a twenty five-year £250 million index-linked Eurobond. BT issued £7,219 million of medium term notes in the year. Commercial paper outstanding decreased by £1,390 million over the year to 31 March 2001.

In the 2000 financial year, there was a net cash outflow of £7,141 million which was partly funded by the issue of new long-term financial instruments, principally two US dollar Eurobonds totalling US\$1.2 billion and a £600 million Eurobond. In that year, BT also drew on commercial paper programmes under which approximately £4.9 billion was outstanding at 31 March 2000 and used the group's existing short-term investments. In the 1999 financial year, a net cash inflow, before liquid resources and financing, of £2,972 million was mainly applied by investing in short-term investments.

The cash outflow for the 2001 financial year resulted in net debt increasing to £27,942 million at 31 March 2001. In the previous financial year, the cash outflow for the year resulted in net debt increasing to £8,700 million at 31 March 2000. This was in contrast to the cash inflow for the 1999 financial year, generated mainly by the MCI share sale proceeds, which resulted in net debt falling to £953 million at 31 March 1999.

Consequently, balance sheet gearing or the ratio of net debt (borrowings net of cash and short-term investments) to shareholders' equity and minority interests stood at 192 per cent. at 31 March 2001, compared with 53 per cent. a year earlier.

In the 2001 financial year, the group borrowed £14,552 million in long-term loans and repaid £225 million in long-term debt. This was in accordance with BT's intention, expressed at the end of the 2000 financial year, to refinance a significant part of its commercial paper borrowings with medium or longer-term debt when market conditions allowed and also to raise further significant finance in the 2001 financial year to meet the financing needs of the UK third-generation licence, won in April 2000, increased capital expenditure and acquisitions of interests in subsidiaries, joint ventures and associates and their additional funding requirements.

In April 2000, BT issued a £250 million 3.5 per cent. index-linked Eurobond repayable in 2025. In December 2000, BT issued four series of notes comprising US\$2.8 billion 8.625 per cent. thirty-year notes, US\$3.0 billion 8.125 per cent. ten-year notes, US\$3.1 billion 7.625 per cent. five-year notes and US\$1.1 billion three-year floating rate notes. In February 2001, BT issued six series of notes comprising £700 million 7.5 per cent. sixteen-year notes, €2.25 billion 6.875 per cent. ten-year notes, €3.0 billion 6.125 per cent. six-year notes, £400 million 7.125 per cent. six-year notes, €1.75 billion 5.625 per cent. three-year notes and €1.0 billion two-year floating rate notes. Loans repaid during the year totalling £225 million were mainly in respect of the Esat Telecom acquisition.

In the 2000 financial year, the group borrowed £1,473 million in long-term loans and repaid £587 million in long-term debt. In May 1999, BT issued a £600 million 5.75 per cent. Eurobond repayable in 2028 and, in October 1999, a US\$1.0 billion five-year 6.75 per cent. Eurobond. In August 1999, BT repaid a US\$200 million Eurobond on maturity which was refinanced by a further ten-year US\$200 million Eurobond. On the acquisition of Esat, BT assumed approximately £550 million of debt, based on Esat's 31 December 1999 balance sheet. In the 1999 financial year, the group repaid long-term debt totalling £457 million; no significant new long-term debt needed to be raised.

In the 2002 financial year, £507 million of long-term debt falls due. The Rights Issue, which closed in June 2001, raised approximately £5.9 billion, net of expenses. Since 31 March 2001, BT has disposed of a number of businesses and assets and has reduced the level of net debt within BT from £27.9 billion at 31 March 2001 to £17.5 billion at 30 June 2001. The Board now expects to reduce net debt to between £15 billion and £17 billion for the BT Group at 31 March 2002 on the assumption that BT's property sale and leaseback transaction has been completed which is expected to raise approximately £2.3 billion.

### Capital resources

During the 2001 financial year, the group increased its level of borrowings so that its net debt was £27.9 billion at 31 March 2001. As noted above, debt has been subsequently reduced through the Rights Issue and sales of investments.

At 31 March 2001, the group had cash and short-term investments of £2,969 million. At that date, £11,629 million of short-term debt was outstanding, comprising principally £3,494 million of borrowings under BT's commercial paper programmes and £7,094 million under its medium-term note programme. In addition, the group had unused committed short-term bank facilities, amounting to



approximately £16,750 million at 31 March 2001, in support of a commercial paper programme or other borrowings. The group also has £460 million of uncommitted short-term bank facilities.

At 31 March 2000, the group had cash and short-term investments of £2,304 million. At that date, £5,121 million of short-term debt was outstanding. In addition, the group had unused committed short-term bank facilities, amounting to approximately £5,800 million at 31 March 2000.

The increase in short-term borrowings in the 2001 financial year was required to finance, in part, BT's acquisitions of third-generation mobile licences and investments during the year.

## Capital expenditure

Capital expenditure by the BT Group on plant, equipment and property totalled £3,755 million in the 2001 financial year, compared with £3,172 million in the 2000 financial year and £2,811 million in the 1999 financial year. Of the total capital expenditure, £3,417 million, £2,791 million and £2,555 million was in the UK in the 2001, 2000 and 1999 financial years, respectively. Work continues on enhancing the intelligence of the network to enable customers to benefit from advanced services and improving the network's capacity to carry high-speed data. ADSL equipment had been installed in 839 UK exchanges by the end of the 2001 financial year as the continuation of the group's plan to roll out this equipment. The group is progressively changing the fixed-network from one based on switched technologies to a modern network based on the internet protocol (IP). In the 2001 financial year 46 trunk exchanges in the core network were cut-over to Next Generation Switches (NGS) which have double the capacity of the earlier exchanges. This brought the total of NGSs to 57 by 31 March 2001. Plans are in place for introducing a further 13 NGSs and for the upgrade and expansion of 27 of the switches to include core Asynchronous Transfer Mode (ATM) switching by March 2002, which potentially doubles the port capacity of each switch. Investment in the access network continued to be driven by demand for both new copper and fibre lines and by quality and resilience improvement programmes. In the 2000 financial year, £233 million was incurred in North America mainly by Concert Communications before the establishment of the Concert global venture in January 2000.

Capital expenditure in the BT Group in the 2002 financial year is expected to be around £3.4 billion. BT Wholesale's capital expenditure is expected to be in the region of £2 billion per annum and BT Ignite's to be approximately £1.0 billion per annum. The BT Group plans to continue to spend on its IP backbone network, in providing web hosting facilities and continuing the expansion of its networks to meet the projected broadband demand. BT Group is focusing capital expenditure on projects with higher and more immediate financial returns. BT Group expects that future capital expenditure will be provided from net cash inflows from operating activities liquidating part of the group's short-term investments and, if required, by external financing.

## Acquisitions

During the 2001 financial year, BT completed a number of acquisitions of businesses, mainly located outside the UK. The total amount invested, including further funding of existing ventures, was £14,501 million.

In April 2000, BT took an equity interest, jointly with Japan Telecom, in a number of regional Japanese mobile phone companies (J-Phone Communications). Instead of investing directly in J-Phone Communications, BT guaranteed bank loans to that group totalling £782 million at 31 March 2001. As noted above, BT's Japanese interests have now been sold for £3.7 billion.

In June 2000, BT acquired for £1,207 million its partner's 50 per cent. interest in Telfort, the communications joint venture which was established in The Netherlands in 1997. Goodwill of £986 million arose on the transaction which is being amortised over a 20-year period.

In the final quarter of the 2001 financial year, BT acquired the 55 per cent. interest in Viag Interkom that it did not already own under agreements made in August 2000. In January 2001, it acquired a 10 per cent. interest from Telenor for £1,611 million, including its share of the German third generation licence and in February 2001, it acquired the remaining 45 per cent. interest from E.ON for £7,148 million, including its share of the cost of licence. Goodwill of £4,992 million arose on the transactions. In the light of falling equity valuations for wireless companies in the 2001 financial year, BT carried out impairment reviews of the carrying values of Viag Interkom and its other major wireless interests. As discussed above, BT recognised a £3,000 million goodwill impairment in Viag Interkom. The remaining goodwill is being amortised over a 20-year period.

Shortly after the end of the 2001 financial year, in April 2001, BT acquired the 49.5 per cent. interest in Esat Digifone that it did not already own, also from Telenor, for £856 million under an agreement made in early 2000.

## *Part 3: Financial review*

During the 2000 financial year, BT also completed a number of acquisitions of businesses or interests in ventures. The total amount invested, including deferred considerations and further funding of existing ventures, was £8,755 million. The investment in the new Concert global venture, in the form of assets contributed, was additional to this.

In November 1999, the group completed the acquisition of the 40 per cent. minority interest in BT Cellnet held by Securicor. The total cost of this acquisition was £3,173 million, including legal fees and other expenses. Goodwill of £2,997 million arose on the transaction which is being amortised over a 20-year period.

BT acquired jointly with AT&T a 30 per cent. interest in Japan Telecom for £1,254 million in August 1999, with BT having an economic interest of 20 per cent. Concurrent with this transaction, BT sold its Japanese subsidiary to Japan Telecom. As already mentioned, Vodafone has now acquired this joint interest.

In Canada, BT acquired an effective 9 per cent. economic interest in AT&T Canada. In conjunction with AT&T, BT jointly purchased 33 per cent. of Rogers Cantel Mobile Communications, a leading mobile operator, leaving BT with an effective interest of approximately 17 per cent. The consideration paid by BT in August 1999 for these two investments totalled £659 million. BT sold its interest in Rogers Cantel in July 2001.

In January 2000, BT and AT&T announced the financial completion of Concert, the global communications joint venture. This venture was formed by BT transferring the majority of its cross-border international network assets, its international traffic, its business with selected multinational customers, together with Concert Communications, and AT&T transferring similar assets and businesses. The provisional unrealised profit on transferring these assets of £159 million was recognised in BT's statement of recognised gains and losses in the 2000 financial year. During the 2001 financial year, certain true-up calculations were made causing a downward adjustment of £49 million to the unrealised profit which was recognised in the statement of recognised gains and losses for the year ended 31 March 2001. The carrying value of Concert on BT's balance sheet at 30 June 2001 was £1,349 million.

In August 1999, BT completed the acquisition of the Yellow Book USA classified directory advertising business based in New York for a total consideration of £415 million. This was sold in June 2001 as part of the Yell disposal. In August 1999, the group also acquired Control Data Systems (renamed Syntegra (USA)), a US-based e-commerce and systems integration company, for £213 million. In May 1999, the group acquired a 20 per cent. interest in SmarTone of Hong Kong, a leading provider of digital mobile communications services, for £241 million.

Under an agreed offer made in January 2000 and separate transactions with two of its major shareholders, BT acquired control of Esat Telecom Group (Esat) at the end of March 2000, following regulatory clearance. The majority of the consideration of £1,558 million was paid in April 2000 after the 2000 financial year end. This Irish communications group held a 49.5 per cent. interest in Esat Digifone, Ireland's second largest mobile phone operator. BT acquired a further 1 per cent. in this company in January 2000, so it also became part of BT at the end of March 2000. On completion of the fair value exercise goodwill of £1,878 million arose on the combined transactions which is being amortised over a 20-year period. As noted above, Telenor was the other shareholder in Esat Digifone, with a 49.5 per cent. interest which BT acquired in April 2001.

In the 1999 financial year, BT acquired from MCI its 24.9 per cent. interest in Concert Communications for £607 million. Goodwill of £568 million arose on this transaction. As explained above, Concert Communications was transferred to the global venture with AT&T in early January 2000.

The group invested £1,326 million in the 1999 financial year on acquiring interests in associates and joint ventures and providing their further funding. The most significant investments were made in October 1998 in the Asia-Pacific region. A 33.3 per cent. stake in Maxis Communications of Malaysia was acquired for £279 million and a 23.5 per cent. interest in LG Telecom in the Republic of Korea was acquired for £234 million. BT continued to share in funding the development of its then ventures, Viag Interkom (£482 million) and Telfort (£103 million).

### **Pensions**

The most recently completed actuarial valuation of the BT Pension Scheme (BTPS), BT's main pension fund, performed for the trustees of the scheme, was carried out as at 31 December 1999. This valuation revealed the fund to be in deficit to an amount of approximately £982 million, after taking credit for a special contribution of £230 million paid by BT in March 2000. Assets of the fund of £29,692 million at that date covered 96 per cent. of the fund's liabilities. This actuarial valuation took into account the anticipated effect of the High Court judgement noted below.

The previous actuarial valuation of the BTPS was carried out as at 31 December 1996. This valuation revealed the fund to be in surplus to an amount of approximately £66 million. This actuarial valuation took into account the effect of the UK Government's measures in July 1997 to end pension funds' ability to reclaim the tax credit associated with UK companies' dividends.

The move into deficit during the three years was mainly the result of the general trend towards longer life expectancy and the effect of redundancies.

The group's annual pension charge for the 2001 financial year of £326 million was based on the December 1999 valuation, but using a slightly higher investment return assumption than was used for the trustees' funding valuation summarised above. The group's pension charges for the 2000 and 1999 financial years of £167 million and £176 million, respectively, were based on the December 1996 valuation. The charges for the three financial years take into account the amount of the pension provision which had been established over recent years in the group's accounts and which stood at £335 million at 31 March 2001. Additionally, under UK accounting standards, the cost of providing incremental pension benefits for early leavers in each of these three financial years has not been charged against the profit in the period in which people agree to leave, since the latest relevant actuarial valuation of the pension fund, together with the pension provision, indicated a surplus. The increase in the charge in the 2001 financial year was due, in part, to the general trend towards longer life expectancy. There was also a smaller amortisation of the combined pension fund position and pension provision held in the BT Group balance sheet. The amortisation credit netted in pension costs amounted to £35 million in the 2001 financial year compared with £163 million in the 2000 financial year.

The group's ordinary contribution into the fund was raised to 11.6 per cent. of employees' pensionable pay for the 2001 financial year compared with 9.5 per cent. of pay during each of the two previous financial years under review. In addition, the company paid special and deficiency contributions into the fund of £100 million in March 2001, £200 million in December 2000, £230 million in March 2000 and £200 million in March 1999 in part because of redundancies. The company is committed to pay deficiency funding contributions of £200 million each year until such time as the deficit is made good. The company may also be required by the trustees of the fund to pay special contributions to cover any costs on the pension fund arising from redundancies. A contribution of around £400 million for this is likely to be paid in the current financial year.

The number of retired members and other current beneficiaries in the pension fund has been increasing in recent years and, at 31 December 2000, was approximately 55 per cent. higher than the number of active members. Consequently, BT's future pension costs and contributions will depend to a large extent on the investment returns of the pension fund and could fluctuate in the medium term.

Following a High Court judgement made in October 1999, the BTPS is liable to pay additional benefits to certain former employees of the group who left under voluntary redundancy terms. These were former employees, in managerial grades, who had joined the group's business prior to 1 December 1971. The value of the additional benefits at 31 March 2001 is estimated at £200 million. On 26 April 2001, an application for permission to appeal against the judgement on behalf of certain former employees in non-managerial grades was lodged in an attempt to extend the additional benefits to those grades. BT will be strongly resisting this new claim and will cross appeal if permission to appeal is given.

An actuarial review of the BTPS was carried out at 31 December 2000. The review, using updated assumptions to those used in the December 1999 valuation, showed that the BTPS had a funding deficit of approximately £1.6 billion. The increased deficit in the year was mainly due to the high level of redundancies since the December 1999 valuation and the fall in global equity markets in 2000. BT Group is continuing to make normal contributions to the fund at the rate of 11.6 per cent. of employee's pensionable pay for the 2002 financial year.

The BTPS was closed to new entrants on 31 March 2001 and a new defined contribution pension scheme was set up which will provide benefits to employees joining the scheme based on their and the employing company's contributions. This change is in line with the practice increasingly adopted by major UK groups and is designed to be more flexible for employees and enable the group to determine its pension costs more precisely than is the case for defined benefit schemes. The financial impact of this change is not expected to be significant in the next several years but it should reduce pension cost volatility in the longer term.

## Property

BT has entered into a legal agreement with Land Securities Trillium and the William Pears Group, for their joint venture company to provide property services to BT. In the process, the group expects to receive a significant cash sum of approximately £2.3 billion which will go towards reducing borrowings. The group anticipates that the transaction will be completed by 31 December 2001. The conditions precedent are primarily conditions relating to satisfactory funding and the finalisation of transactional commercial documentation. Detailed commercial and legal negotiations continue. The main continuing impact on the results from this transaction

## **Part 3: Financial review**

is expected to be an increase in operating lease rental expenses, partly offset by the beneficial impact on interest costs and depreciation charges.

### **New UK accounting standards**

Under a new UK accounting standard FRS 19 — Accounting for deferred tax, the group is required to provide for deferred tax on a full liability basis from 1 April 2001, in place of the previous requirement to provide only for that deferred tax which the group considered it would be paying in the foreseeable future. The impact of this new standard has been to reduce the group's distributable reserves by approximately £2 billion. The adverse impact of the standard on annual profit after tax is estimated at around £60 million and 0.8 pence reduction in earnings per share. This new accounting standard has no effect on the actual corporation tax to be paid or on cash flows. The standard allows companies to discount their deferred tax liabilities. BT has not adopted this discounting approach since it is not in line with US GAAP and it might introduce unnecessary volatility into the profit and loss account.

Under a new UK accounting standard FRS 17 — Accounting for retirement benefits, the method of accounting for defined benefit pensions will be substantially changed. BT is required to adopt fully this new standard by its 2004 financial year. This standard is expected to have the effect of increasing the pension costs to be included in operating costs, thus reducing operating profit, but this will be offset in part by financing costs being reduced. Pension fund actuarial gains and losses, including investment returns varying from the assumed returns, will be recorded in full in the statement of total recognised gains and losses annually. Pension fund deficits, calculated in accordance with prescribed rules in the standard, will be shown in the balance sheet as will any surpluses to the extent the group expects to obtain value from them in the foreseeable future.

## Part 4: First quarter results of BT

The following is the full text of the first quarter unaudited results of BT which were published on 26 July 2001. In this announcement references to “Future BT” mean BT Group and references to “BT Wireless” mean mmO<sub>2</sub>.

### “First Quarter Results to 30 June 2001

BT’s results for the first quarter ended 30 June 2001 are summarised in the following table.

	Results for the first quarter to 30 June	
	2001 £m	2000 £m
Group turnover	5,454	4,732
EBITDA	1,519	1,518
Group operating profit	505	755
Net interest charge	474	239
Profit before goodwill amortisation, exceptional items and taxation	186	637
Profit on sale of group undertakings and fixed asset investments	4,484	41
Profit before taxation	4,505	561
Profit after taxation	4,360	353
Earnings per share	57.9p	4.2p
Earnings per share before exceptional items and goodwill amortisation	0.3p	5.7p

### Chairman’s statement

Sir Christopher Bland, BT’s Chairman, said:

“The first quarter has been one of considerable progress in lowering group debt. Disposals and the rights issue combined to reduce net debt to £17.5 billion, compared with £27.9 billion at the end of March.

The first quarter’s operating performance was satisfactory. Our EBITDA was maintained at £1,519 million with a welcome improvement in BT Retail and BT Ignite offset by the negative EBITDA in Viag Interkom and Telfort consolidated for the first time.”

### Key features

#### Group

- Disposals of investments and businesses generating £6.0 billion in cash and £4.5 billion in profit in the quarter
- Successful £5.9 billion rights issue launched and completed
- Balance sheet gearing at 79 per cent. with net debt at £17.5 billion at end of June 2001, a reduction of £10.4 billion in the quarter
- Work continues on implementation of the radical restructuring

#### Future BT

- Future BT EBITDA increased by 5.9 per cent. to £1,428 million
- Group turnover in Future BT increased by 12.5 per cent. to £4,498 million
- Disappointing Concert global venture results — BT’s share of its operating loss before goodwill amortisation at £81 million for the quarter
- Capital expenditure on property, plant and equipment reduced by 9.0 per cent. to £705 million in Future BT
- ADSL roll out extends to 890 exchanges at 30 June 2001 serving 50 per cent. of UK householders
- BT Ignite’s integrated broadband enabled IP network covers more than 52,000 km in 12 countries

#### BT Wireless

- BT Cellnet’s customer base grew by 300,000 in the quarter to stand at 10.9 million at 30 June 2001
- Viag Interkom’s mobile customer base at 3.4 million at 30 June 2001
- UMTS infrastructure sharing announced with T-Mobile International in both German and UK markets
- BT Cellnet’s EBITDA increased by 34 per cent.
- Genie achieves around 5.5 million registered users world-wide

## Part 4: First quarter results of BT

### The transformation of BT

We have made good progress in the three months ended 30 June 2001 in transforming BT and, in particular, achieving our priority of a significant reduction in our net debt from its unsustainable level at 31 March 2001.

On 10 May 2001, we announced our intention to demerge BT Wireless. We are on schedule to carry out this demerger and have announced key appointments to the BT Wireless board. We anticipate that we will be writing to shareholders with details of the process and the notice of the necessary extraordinary general meeting later this year.

On 10 May 2001, we announced our intention to sell or demerge Yell, our classified advertising business. On 26 May 2001, we announced the agreement to sell Yell and this sale was completed on 25 June 2001 for approximately £2 billion.

On 2 May 2001, we announced that we had agreed to sell our interests in Japan Telecom and J-Phone, and our interest in Airtel in Spain, both to Vodafone. The transactions were completed in June and July with the Japanese investments sold for £3.7 billion and our interest in Airtel for £1.1 billion. Of the consideration for the Japanese investments the final element of £634 million was received early in July 2001.

On 10 May 2001, we announced a 3 for 10 rights issue at 300 pence per share. The rights issue, the largest ever in the UK, was well supported by shareholders and closed, as planned, on 15 June 2001. We issued 1.98 billion new shares for a total consideration of £5.9 billion, net of expenses.

BT's continuing business, referred to as Future BT, will focus on its European network and retail business concentrating on wire and data services. Its main lines of business are BT Wholesale, BT Retail, BT Ignite and BTopenworld, together with BT Affinitis and BTexact Technologies. Our Concert joint venture with AT&T continues to operate alongside Future BT pending resolution of its future.

The steps described above have resulted in cash inflows of £11.9 billion in the quarter and, taking into account cash flows from operations and capital expenditure, tax, interest and other payments, we have reduced net debt by £10.4 billion down to £17.5 billion at 30 June 2001. We are ahead of schedule to meet our debt reduction target.

### Lines of Business

BT's new lines of business were established during the year ended 31 March 2001. The results by line of business in the first quarter were:

	First quarter ended 30 June 2001 <sup>(i)</sup>		
	Group turnover £m	EBITDA £m	Group operating profit (loss) before goodwill amortisation and exceptional items £m
BT Retail	2,994	361	316
BT Wholesale	2,989	960	487
BT Ignite	1,016	36	(78)
BTopenworld	46	(38)	(41)
Other	104	109	14
Eliminations <sup>(ii)</sup>	(2,651)	—	—
Total Future BT	4,498	1,428	698
BT Wireless	1,037	64	(95)
Discontinued operations	171	41	37
Eliminations and other <sup>(ii)</sup>	(252)	—	—
Total before exceptional items	5,454	1,533	640

#### Notes:

(i) See note 2(a) for prior year figures.

(ii) Includes elimination of turnover between businesses which is included in total turnover of the originating business.

## BT Retail

	First quarter ended June 30	
	2001 £m	2000 £m
Group turnover	2,994	2,961
EBITDA	361	269
Operating profit	316	225
Capital expenditure	30	53

BT Retail achieved an operating profit of £316 million, before exceptional items, in the quarter on turnover of £2,994 million. In the corresponding quarter of last year, BT Retail contributed a profit of £225 million on turnover of £2,961 million.

BT Retail's turnover is mainly derived from calls, lines, private services and total business solutions to the consumer, small and medium enterprises (SME) and major business markets. BT Retail provides an end to end service to 21 million customers over 28.2 million lines in the UK. Turnover for the quarter is summarised as follows:

### BT Retail turnover

	2001 £m	2000 £m
Fixed-network calls	1,155	1,238
Exchange lines	887	823
Private services	153	159
Customer premises equipment supply	144	152
Other sales and services	253	265
Total external sales	2,592	2,637
Sales to other BT businesses	402	324
Total	2,994	2,961

Turnover from fixed-network calls declined by 6.7 per cent. to £1,155 million compared to the corresponding quarter of last year; the prevailing trend whereby volume growth has been more than offset by price reductions continued.

The trend in fixed-network call volumes is illustrated in the table below:

### Fixed-network calls volume growth

	12 months moving average volume growth (decline)							
	June 2001 %	March 2001 %	December 2000 %	September 2000 %	June 2000 %	March 2000 %	December 1999 %	September 1999 %
<b>Non-geographic calls:</b>								
Internet related and other	21	38	57	69	87	95	112	126
Fixed to mobile	24	30	36	42	46	48	49	47
<b>Geographic calls:</b>								
Local	(11)	(12)	(12)	(11)	(10)	(9)	(8)	(6)
National	(7)	(7)	(8)	(7)	(6)	(4)	(3)	(1)
International	(2)	(3)	(5)	(6)	(5)	(3)	(2)	0
Overall	1	2	4	5	6	7	8	9

The adverse mix effect of the increase in calls from fixed to mobile and the internet, with declines in geographic calls, continued in the quarter.

The introduction of BT Together packages offered customers lower priced calls and for the first time unmetered local calls in the evening and weekend for a fixed fee. The combined effect of the price changes to fixed-network calls totalled approximately £90 million in the first quarter, which was equivalent to a 6 per cent. reduction in call prices. The results include the impact of increases in free call allowances which were introduced along with increased line rental charges.

The main volume growth in fixed-network calls in the first quarter was derived from continued growth in calls to mobile phones and the increased use of the internet. Call volumes grew by 1 per cent., on a 12 month moving average basis. While fixed to mobile and internet

## Part 4: First quarter results of BT

related local calls continue to grow strongly, traditional geographic fixed-network calls declined in volume reflecting mobile phone substitution and intense competition, offset by customer take up of new BT Together packages.

Turnover from exchange lines grew by 7.8 per cent. in the quarter to £887 million. The increased turnover was the combined result of the growth in business lines and rental price increases.

The number of BT Retail's business lines grew by 3.8 per cent. over the year to 30 June 2001, with ISDN services being the main driver behind this growth. The numbers of residential lines declined very slightly due to competition from other fixed line providers, largely offset by the high number of BT customers installing second lines. The decline in residential primary lines in the quarter to 30 June 2001 was much lower than in recent quarters which we attribute to the success of the BT Together packages in attracting and retaining customers. Overall BT Retail's total fixed-network lines grew by 1.0 per cent. to 28.2 million over the year to 30 June 2001.

During June, BT Retail promoted BT Answer 1571. This is a free service and allows BT customers to have their calls answered even when they are on the phone. The service saves up to 10 messages and is expected to result in a significant increase in the number of completed calls.

BT Retail's sales to other BT lines of businesses increased by 24 per cent., primarily in the provision of circuits to BT Wholesale for onward sale to mobile operators and provision of services to BT Ignite for sale as part of its end to end solutions services.

BT Retail's gross margin has increased by £20 million to £872 million over the same quarter last year. BT Retail's operating costs including redundancy in the quarter reduced by £58 million compared to the corresponding quarter last year. This was achieved through the transformation programme which seeks to reduce BT Retail's costs by £240 million in this financial year. Much of the saving was achieved through reduction in people numbers and the number of full time employees in BT Retail at 30 June 2001 was approximately 5,700 (10 per cent.) lower at 50,300 compared to 30 June 2000.

### BT Wholesale

	First quarter ended June 30	
	2001 £m	2000 £m
Group turnover	2,989	2,798
EBITDA	960	1,015
Operating profit	487	595
Capital expenditure	445	480

The majority of BT Wholesale's turnover is internal to the BT Group in providing UK network services to BT Retail, BT Wireless and the other BT lines of business. Its external turnover, which totalled £867 million in the quarter, is derived from providing wholesale products and solutions to other operators, including Concert, inter-connecting with BT's UK fixed-network.

Turnover increased 7 per cent. to £2,989 million compared with the first quarter of last year, driven by a 12 per cent. growth in product volumes. Turnover generated from external sales was strong in the quarter and at £867 million was 31 per cent. higher year on year. Transit and conveyance revenues generated from other UK operators interconnecting with the BT network were higher by 42 per cent. Turnover from transit traffic has a low profit margin. Private circuit revenues were 43 per cent. higher reflecting a significant demand for high bandwidth circuits. Internal turnover was marginally lower mainly due to a reduction in prices with BT Retail estimated at £28 million for the quarter. Revenues generated from the Concert joint venture fell by 17 per cent. to £138 million.

BT Wholesale's operating costs rose by 14 per cent. year on year to £2,502 million. A major element of these costs is payments to other BT lines of business which amounted to £1,028 million in the quarter. Of this total, £530 million was due to BT Retail for field engineering services and for the cost of sales of BT Retail's products mainly on sold to other network operators; £231 million was due to BT Affinitis mainly for building, transport and computing services and £122 million to BT Wireless largely for interconnect of calls to its customers' phones. The principal reasons for the underlying increase in operating costs in the quarter were:

- Higher payments to other operators for interconnect — external payments increased by 22 per cent. to £843 million largely due to increases in the volume and proportion of traffic with mobile operators.
- Depreciation costs rose by 13 per cent. to £473 million mainly due to the increase in levels of investment over the latter half of last year.

BT Wholesale's capital expenditure on plant and equipment was £445 million, 7 per cent. lower than in the corresponding quarter last year. BT Wholesale's strong cash generation capability was demonstrated by a free operating cash flow (EBITDA less capex) of £515 million, compared with £535 million in the same period last year.



DSL services continue to be sold to other UK network operators, service providers and corporates through three distributor channels — BT Wholesale, BT Ignite and BT Retail. To date, 179 wholesale customers have signed up and BT has connected over 70,000 ADSL subscribers across this customer base. 50 per cent. of UK households are now connected to an ADSL enabled exchange and BT Wholesale is on target to increase this to 60 per cent. by the end of September when some 13 million homes will be connected to an enabled exchange.

BT Wholesale has completed a 12 month project which has resulted in one of the world's largest all new Synchronous Digital Hierarchy (SDH) broadband overlay transmission networks with points of presence (PoPs) in 800 sites which cover all of the main towns and cities across the UK. The network of fibre, amounting to 30,000 kms, provides the platform to supply customers with leading-edge high capacity products and to meet demand for the new growth areas of high bandwidth data communications, broadband (DSL) and advanced private circuits.

Local Loop Unbundling (LLU) is becoming an established business product. BT has made more than 1,500 contract offers making available hostel space in more than 250 exchanges to LLU operators. Currently more than 40 BT exchanges have been enabled for LLU. BT has met all demand for unbundled lines since January 2001.

## BT Ignite

	First quarter ended June 30	
	2001 £m	2000 £m
Group turnover	<b>1,016</b>	752
EBITDA	<b>36</b>	(39)
Group operating loss*	<b>(78)</b>	(101)
Share of losses of associates and joint ventures*	<b>(15)</b>	(40)
Capital expenditure	<b>142</b>	133

### Note:

\*before goodwill amortisation

BT Ignite offers a wide range of services including value added IP and data services, systems integration, complex solutions, content hosting, media distribution and applications service provision. An analysis by area of activity is set out in note 2.

Ignite Content Hosting provides advanced web and application hosting services for customers allowing their businesses to meet growing requirements for e-commerce. Following the acquisition in the quarter of Fluxus, a leader in the French market for managed hosting services, Ignite Content Hosting now has a presence in all major western European countries.

BT Ignite's European interests are marked by presence through nine European metropolitan city networks and coverage in over 250 European towns and cities, with 22 web hosting centres.

BT Ignite comprises wholly owned and other operations from 12 countries serviced by an integrated broadband enabled IP network covering more than 52,000 km.

BT Ignite's group turnover was £1,016 million for the quarter ended 30 June 2001, growing by 35 per cent. compared to the same period last year. Approximately half of this growth arises from the Telfort and Viag Interkom acquisitions made last year. Earnings before interest, taxation, depreciation and amortisation were £36 million. Group operating loss before goodwill amortisation was £78 million, compared to a loss of £101 million for the same period last year. The improvement was driven by the growth in UK IP revenues of approximately 50 per cent.

Over 60 per cent. of BT Ignite's total turnover was derived from high end value-added IP services including systems integration and outsourcing, complex solutions, content hosting and media distribution services and application service provision. BT Ignite plans to continue to build its revenues from the high end of this value chain. Turnover for these services amounted to £656 million and grew by 20 per cent. year on year.

Turnover from connectivity and network access services (including broadband and internet services, European connectivity and other) amounted to £466 million. Excluding acquisitions, this turnover grew by 33 per cent. over the same period last year.

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### BTopenworld

	First quarter ended June 30	
	2001 £m	2000 £m
Group turnover	46	26
EBITDA	(38)	(34)
Group operating loss*	(41)	(37)
Share of losses of associates and joint ventures*	(4)	(36)
Capital expenditure	2	22

Note:

\*before goodwill amortisation

BTopenworld's revenue is derived principally from its UK narrowband internet access services as well as its new UK broadband fast and always on, internet access internet services. The total number of UK internet service provider customers of BTopenworld at 30 June 2001 was approximately 1.3 million, representing annual growth of approximately 85 per cent. With over 760,000 customers on unmetered packages on 30 June 2001, BTopenworld is the leading UK unmetered internet access provider, based on published figures.

BTopenworld incurred an operating loss of £41 million on revenue of £46 million in the quarter. BTopenworld's turnover was 77 per cent. up on the same quarter last year (£26 million) and 7 per cent. up on the previous quarter (£43 million). The improvement is due to the significant growth in the narrowband business and the launch and steady growth of the broadband business. The operating loss in the quarter was higher than in the same quarter last year due to early losses in the broadband business which was launched in September 2000. However, BTopenworld's operating loss was £50 million lower than in the quarter to 31 March 2001 reflecting the effectiveness of cost saving measures in its core business. BTopenworld's share of associates losses was £4 million which compares favourably with the same quarter last year (£36 million). This is due to BTopenworld's recent exit from certain loss making ventures, notably BiB.

### BT Wireless

	First quarter ended June 30	
	2001 £m	2000 £m
Group turnover	1,037	764
EBITDA	64	116
Group operating profit (loss)*	(95)	45
Share of profits (losses) of associates and joint ventures*	3	(55)
Capital expenditure	284	173

Note:

\*before goodwill amortisation

BT Wireless turnover rose to £1,037 million, an increase of 36 per cent. over the corresponding quarter last year. The acquisition of Viag Interkom and Telfort contributed £239 million of this growth.

Earnings before interest, tax depreciation and amortisation (EBITDA) were £64 million. BT Cellnet contributed £166 million, an increase of 34 per cent. This was partly offset by losses at our newer businesses, Viag Interkom, Telfort and Genie.

BT Wireless incurred an operating loss of £95 million before goodwill amortisation and exceptional items in the quarter against a profit of £45 million in the same quarter of the previous year. The principal reason for the change is the incorporation of operating losses from Viag Interkom and Telfort amounting to £154 million.

BT Wireless has redefined the method of counting active customers in its customer bases and it now excludes all pre-pay customers who have not made or received a call within the last three months. On this basis, at 30 June 2001, BT Wireless had 16.2 million active mobile subscribers, a rise of 3 per cent. on the quarter.

BT Cellnet's customer base increased by about 300,000 over the quarter to 10.9 million active customers. Operating profit before exceptional items was £97 million, a growth of 52 per cent. year on year. This results from improving post-pay ARPU's and continued cost savings. BT Cellnet's service revenue, the turnover from its customers' use of their phones from calls, interconnect and roaming, grew by 10 per cent.

Viag Interkom had a 3.4 million customer base of active users at 30 June 2001, an increase of 4 per cent. on the quarter. Turnover grew by 55 per cent. to £199 million and the operating loss was £123 million in the quarter. Viag Interkom's service revenue grew by 38 per cent. BT Wireless is focusing on the cost base of Viag Interkom.

Genie's turnover was £11 million in the quarter with an operating loss of £38 million. At 30 June 2001, Genie had about 5.5 million registered customers, a 41 per cent. increase of new registrations over the last quarter. Genie has also shown a strong usage growth of 37 per cent. to reach a monthly average of 103 million WAP page impressions.

In advance of demerger later this year, the management team has been strengthened in recent months with the appointment of David Varney as Chairman-designate. David Finch will become Finance Director. Andrew Sukawaty has been appointed to be the non-executive Deputy Chairman of the new group and Paul Myners to be a non-executive director. Additionally, actions have been taken to improve operating performance and cost containment, reflected in the recent announcement on UMTS infrastructure sharing with T-Mobile International in both the German and UK markets.

## **Group Results**

Group turnover increased by 15.3 per cent. to £5,454 million in the three months to 30 June 2001. The principal areas of growth were through the acquisitions of full control over Viag Interkom and Telfort in the 2001 financial year and from interconnect with UK operators.

BT's EBITDA for the quarter was maintained at £1,519 million with improvement in BT Retail and BT Ignite offset by the negative EBITDA in Viag Interkom and Telfort consolidated for the first time.

BT's group operating profit before goodwill amortisation and exceptional items declined by 23 per cent. to £640 million mainly arising from higher depreciation charges both in newly consolidated wireless networks in continental Europe and in the UK fixed-network.

The number of people employed by BT at 30 June 2001 was 132,400 of which 16,300 were in BT Wireless. We have identified productivity improvements and cost savings to reduce costs by approximately £575 million in the current financial year. We are on track to achieve these savings.

BT's share of its ventures' operating profits for the quarter was £20 million before goodwill amortisation compared with £45 million in the corresponding quarter of last year. The adverse change was principally due to the Concert joint venture which incurred an operating loss of £81 million in the quarter. BT continues to hold a 26 per cent. interest in Cegetel which contributed £44 million to total operating profit before goodwill amortisation. Ventures in which BT is no longer a continuing investor, principally in Japan, contributed £68 million to total operating profit in the quarter before goodwill amortisation.

## **Concert**

Concert's loss attributable to BT in the quarter was £81 million, compared to a profit of £60 million in the prior year. Concert has experienced reducing prices in a highly competitive international market and its network capacity utilisation is low. Management actions to improve the financial position include redundancies and a strict control of capital expenditure. BT and AT&T are discussing ways to improve the performance of the business.

## Part 4: First quarter results of BT

### Disposals

One of the main features of the quarter ended 30 June 2001 was the success we achieved in disposing of non-core businesses as part of our drive to reduce our debt. The consideration for these disposals totalled £7,007 million and £6,010 million was received in cash in the quarter. The profit before taxation from the disposals totalled £4,484 million as shown in the following table.

	Consideration £m	Profit before tax £m
Japan Telecom and J-Phone Communications	3,709	2,364
Airtel	1,084	844
Yell	1,960	1,149
BiB	241	120
Other	13	7
<b>Total</b>	<b>7,007</b>	<b>4,484</b>

BT completed the sale of its economic 20 per cent. interest in Japan Telecom and its 20 per cent. interest in J-Phone Communications on 1 June 2001 to Vodafone and subsequently its interest in J-Phone group companies. Of the total proceeds of sale of £3,709 million, £3,075 million was received in June 2001 and the balance was received earlier in July. The profit of £2,364 million compares with BT's original investment of £836 million in Japan Telecom in August 1999.

BT completed the sale of its 18 per cent. interest in Airtel, a major Spanish wireless operator, to Vodafone for £1,084 million on 29 June 2001. The profit of £844 million on the sale compares with BT's investment in the company of £223 million, built up during the 1990s.

The sale of Yell, BT's classified advertising directory businesses in the UK and the USA was completed on 25 June 2001 for a consideration of £1,960 million, giving a profit of £1,149 million, subject to certain final adjustments for the net asset position on disposal. In May 2001, the UK Office of Fair Trading announced that the price controls over the UK Yellow Pages advertising rates were to be tightened significantly. The price we achieved for the sale of Yell, which was announced on 26 May 2001, reflected the impact of these controls on Yell's prospects.

Our former interest in British Interactive Broadcasting was diluted in July 2000 when BSkyB gained control and in May 2001 we agreed to exchange our residual interest in BiB for tranches of shares in BSkyB. We received the first tranche of 19 million BSkyB shares with an initial value of £128 million on 28 June 2001, 50 per cent. of which we are required to hold for at least twelve months. We are due to receive the second tranche of BSkyB shares with a similar value in November 2002. If BiB develops satisfactorily, we stand to gain a further tranche of BSkyB shares in due course. The profit of £120 million on this exchange which we have recognised in the three months to 30 June 2001 relates to the BSkyB shares which we may sell on receipt. Under UK accounting rules, we shall recognise the remaining gain on the transaction of £121 million, based on current values, when we are permitted to market the shares.

We have sold our interest in Rogers Wireless to AT&T Wireless Services for £269 million. This sale completed in July 2001 but we have recognised the loss of £24 million on this transaction in the three months to 30 June 2001.

On 4 May 2001, we announced that we had agreed in principle to sell our interest in Maxis Communications in Malaysia for £350 million. This transaction is subject to regulatory and other approvals.

### Interest

Net interest, including BT's share of its ventures' interest charge, rose by £235 million to £474 million in the quarter. Of the total charge, £440 million arose in the BT Group and £34 million relates to ventures. The increase in the group's interest charge of £255 million is a consequence of the debt incurred by the group to finance its acquisitions and the third generation mobile licences in the 2001 financial year.

Net interest in future quarters of the year is expected to fall from the level of the first quarter reflecting the significant reduction in net debt in the quarter.

### Taxation

The tax charge of £145 million is based on profit before taxation before the profit on disposals. We have adopted the new FRS 19 "deferred tax" accounting standard this quarter. Although it has not had a significant effect on the tax charge, we have transferred £2,015 million from reserves to the deferred tax provision in the balance sheet in respect of previously unprovided deferred tax. This new standard does not affect the amount of tax payable in cash.

### Earnings per share

BT's earnings per share for the quarter ended 30 June 2001 were 57.9 pence based on a profit before taxation of £4,505 million. This profit included the following exceptional items:

- Profit of £4,484 million from the disposal of fixed asset investments and group undertakings, principally on our investments in Japan
- Costs related to the BT Wireless demerger of £14 million

Earnings per share before these exceptional items and goodwill amortisation were 0.3 pence compared with 5.7 pence in the first quarter of the last financial year. Loss per share of continuing operations on this basis of 0.3 pence compared with earnings of 4.5 pence in the comparable period. The lower earnings in the current period were mainly due to higher interest charges following BT's acquisition of businesses and third generation licences over the past year, and losses incurred by the Concert global venture and Viag Interkom.

### Cash flow and net debt

Cash inflow from operating activities amounted to £1,254 million in the quarter ended 30 June 2001. The group's significant cash flows in the quarter leading to the £10 billion reduction in net debt are summarised in the following table.

	First quarter ended 30 June 2001 £m
Net cash outflow from capital expenditure on property, plant and equipment, and interest and tax payments less cash inflow from operating activities	(417)
Acquisitions of subsidiaries and funding of ventures*	(942)
Disposals of businesses and ventures	6,010
Other movements	132
Net cash inflow before financing	4,783
Proceeds of rights issue	5,876
Reduction in net debt through cash flow	10,659

\*primarily Esat Digifone (see below)

Our credit rating was lowered in the quarter by Moody's and Standard and Poors' with the consequence that the interest payable on our global and Eurobond bonds with a combined principal value of £13 billion was increased by 25 basis points.

Gearing (net debt as a percent of shareholders' funds and minority interests) at 30 June 2001 stood at 79 per cent. with net debt of £17.5 billion compared with £27.9 billion at 31 March 2001. We have temporarily invested a significant part of the proceeds of our rights issue and the proceeds of our divestments in short-term financial instruments before applying the funds to reduce our gross debt. Shareholders' funds have increased in the quarter by £7,889 million from those previously reported at 31 March 2001 mainly due to the beneficial effect of the rights issue of £5,876 million and the profit on disposals partly offset by the restatement effect of adopting FRS 19 which reduced reserves by £2,015 million. Shareholders funds stood at £21,958 million at 30 June 2001.

### Capital expenditure

Capital expenditure on plant, equipment and property in the quarter of £990 million compared with £950 million in the first quarter of the previous year. The expenditure in the quarter includes £149 million spent by our newly acquired subsidiaries in Germany and The Netherlands. Work continues on enhancing the UK fixed-network to enable customers to benefit from new wave communications technologies.

For the financial year ending 31 March 2002, we continue to expect capital expenditure on plant, equipment and property to be around £4.9 billion, of which £1.5 billion would be incurred by BT Wireless.

### Esat Digifone

On 18 April 2001, the group completed the purchase of the 49.5 per cent. interest in Esat Digifone it did not already own for £869 million.

### Property

On 13 June 2001, BT announced that it had reached a stage in its commercial discussions with Land Securities Trillium and William Pears group which allowed it to proceed with the proposed transaction to divest BT's property portfolio, subject to financing. On

#### ***Part 4: First quarter results of BT***

completion, which is expected later this autumn, BT will receive a cash payment of approximately £2.3 billion, subject to changes in interest rates.

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The second quarter and half year's results are expected to be announced on 8 November 2001.

**GROUP PROFIT AND LOSS ACCOUNT**  
for the three months ended 30 June 2001

(unaudited)	Notes	Contin- uing activities £m	Discon- tinued activities (note 1) £m	Total £m
<b>Total turnover</b>		6,249	805	7,054
Group's share of associates and joint ventures turnover		(1,131)	(634)	(1,765)
Trading between group and principal joint venture		165	—	165
<b>Group turnover</b>	2	5,283	171	5,454
Other operating income	3	101	—	101
Operating costs		(4,912)	(138)	(5,050)
Group operating profit	2	472	33	505
Group's share of operating profits (losses) of associates and joint ventures	4	(67)	57	(10)
Total operating profit		405	90	495
Profit on sale of fixed asset investments and group investments	5	127	4,357	4,484
Net interest payable	6	(456)	(18)	(474)
<b>Profit before taxation</b>		76	4,429	4,505
<b>Profit before goodwill amortisation, exceptional items and taxation</b>	7	94	92	186
<b>Taxation</b>		(111)	(34)	(145)
<b>Profit (loss) after taxation</b>		(35)	4,395	4,360
Minority interests		—	(13)	(13)
<b>Profit (loss) attributable to shareholders</b>		(35)	4,382	4,347
<b>Earnings (loss) per share</b>	7			
— basic		(0.5)p	58.4p	57.9p
— diluted		(0.5)p	57.9p	57.4p
<b>Earnings (loss) per share before goodwill amortisation and exceptional items</b>	7			
— basic		(0.3)p	0.6p	0.3p
— diluted		(0.3)p	0.6p	0.3p

*Part 4: First quarter results of BT*

**GROUP PROFIT AND LOSS ACCOUNT**  
for the three months ended 30 June 2000

(unaudited)	Notes	Contin- uing activities £m	Discon- tinued activities (note 1) £m	Total £m
<b>Total turnover</b>		5,658	1,133	6,791
Group's share of associates and joint ventures turnover		(1,254)	(968)	(2,222)
Trading between group and principal joint venture		163	—	163
<b>Group turnover</b>	2	4,567	165	4,732
Other operating income	3	88	—	88
Operating costs		(3,946)	(119)	(4,065)
Group operating profit	2	709	46	755
Group's share of operating profits (losses) of associates and joint ventures	4	(126)	130	4
Total operating profit		583	176	759
Profit on sale of fixed asset investments and group investments	5	41	—	41
Net interest payable	6	(211)	(28)	(239)
<b>Profit before taxation</b>		413	148	561
<b>Profit before goodwill amortisation, exceptional items and taxation</b>	7	456	181	637
<b>Taxation</b>		(147)	(61)	(208)
<b>Profit after taxation</b>		266	87	353
Minority interests		(17)	(30)	(47)
<b>Profit attributable to shareholders</b>		249	57	306
<b>Earnings per share</b>	7			
— basic		3.4p	0.8p	4.2p
— diluted		3.4p	0.7p	4.1p
<b>Earnings per share before goodwill amortisation and exceptional items</b>	7			
— basic		4.5p	1.2p	5.7p
— diluted		4.4p	1.2p	5.6p



**GROUP PROFIT AND LOSS ACCOUNT**  
for the year ended 31 March 2001

	Notes	Contin- uing activities £m	Discon- tinued activities (note 1) £m	Total £m
<b>Total turnover</b>		24,089	5,577	29,666
Group's share of associates and joint ventures turnover		(5,109)	(4,828)	(9,937)
Trading between group and principal joint venture		698	—	698
<b>Group turnover</b>	2	19,678	749	20,427
Other operating income	3	393	—	393
Operating costs		(20,176)	(583)	(20,759)
Group operating profit (loss)	2	(105)	166	61
Group's share of operating profits (losses) of associates and joint ventures	4	(821)	424	(397)
Total operating profit (loss)		(926)	590	(336)
Profit on sale of fixed asset investments and group investments	5	619	—	619
Net interest payable	6	(1,211)	(103)	(1,314)
<b>Profit (loss) before taxation</b>		(1,518)	487	(1,031)
<b>Profit before goodwill amortisation, exceptional items and taxation</b>	7	1,456	616	2,072
<b>Taxation</b>		(509)	(203)	(712)
<b>Profit (loss) after taxation</b>		(2,027)	284	(1,743)
Minority interests		(2)	(125)	(127)
<b>Profit (loss) attributable to shareholders</b>		(2,029)	159	(1,870)
<b>Earnings (loss) per share</b>	7			
— basic		(27.9)p	2.2p	(25.7)p
— diluted		(27.9)p	2.2p	(25.7)p
<b>Earnings per share before goodwill amortisation and exceptional items</b>	7			
— basic		13.6p	3.9p	17.5p
— diluted		13.4p	3.9p	17.3p

*Part 4: First quarter results of BT*

**GROUP CASH FLOW STATEMENT**  
for the three months ended 30 June 2001

	Notes	First quarter ended June 30		Year ended March 31
		2001 (unaudited) £m	2000 £m	2001 (note 1) £m
<b>Net cash inflow from operating activities</b>	8	<b>1,254</b>	1,427	5,887
<b>Dividends from associates and joint ventures</b>		—	5	10
<b>Net cash outflow from returns on investments and servicing of finance</b>		<b>(541)</b>	(219)	(727)
<b>Taxation paid</b>		<b>(94)</b>	(119)	(669)
Purchase of intangible fixed assets		—	(3,929)	(4,208)
Purchase of tangible fixed assets		<b>(1,036)</b>	(1,038)	(4,756)
Net sale of fixed asset investments		<b>15</b>	2	82
Sale of tangible fixed assets		<b>117</b>	23	440
<b>Net cash outflow for capital expenditure and financial investment</b>		<b>(904)</b>	(4,942)	(8,442)
Acquisitions		<b>(942)</b>	(2,327)	(14,501)
Disposals		<b>6,010</b>	92	747
<b>Net cash inflow (outflow) for acquisitions and disposals</b>		<b>5,068</b>	(2,235)	(13,754)
<b>Equity dividends paid</b>		—	—	(1,432)
<b>Cash inflow (outflow) before use of liquid resources and financing</b>		<b>4,783</b>	(6,083)	(19,127)
<b>Management of liquid resources</b>		<b>(7,837)</b>	(521)	(480)
Issue of ordinary share capital	12	<b>5,876</b>	109	149
Issue of shares to minorities		—	—	36
New loans		<b>1</b>	1,396	14,552
Repayment of loans		<b>(290)</b>	(211)	(225)
Net movement on short-term borrowings		<b>(1,932)</b>	5,340	5,223
<b>Net cash inflow from financing</b>		<b>3,655</b>	6,634	19,735
<b>Increase in cash</b>		<b>601</b>	30	128
<b>Decrease (increase) in net debt</b>	10	<b>10,659</b>	(5,974)	(18,942)

**GROUP BALANCE SHEET**  
at 30 June 2001

	Notes	June 30		March 31
		2001 (unaudited) £m	2000 (note 1) £m	2001 (note 1) £m
<b>Fixed assets</b>				
Intangible assets	9	18,297	11,147	18,380
Tangible assets		21,610	18,787	21,625
Investments		3,675	6,910	5,204
		<b>43,582</b>	<b>36,844</b>	<b>45,209</b>
<b>Current assets</b>				
Stocks		289	233	361
Debtors		7,380	5,734	6,260
Investments		10,754	2,575	2,557
Cash at bank and in hand		388	345	412
		<b>18,811</b>	<b>8,887</b>	<b>9,590</b>
<b>Creditors: amounts falling due within one year</b>				
Loans and other borrowings		10,990	11,538	12,136
Other creditors		8,961	9,094	8,597
		<b>19,951</b>	<b>20,632</b>	<b>20,733</b>
<b>Net current liabilities</b>				
		<b>(1,140)</b>	<b>(11,745)</b>	<b>(11,143)</b>
<b>Total assets less current liabilities</b>				
		<b>42,442</b>	<b>25,099</b>	<b>34,066</b>
<b>Creditors: amounts falling due after more than one year</b>				
Loans and other borrowings		17,633	6,736	18,775
Provisions for liabilities and charges	11	2,769	3,108	2,738
Minority interests		82	579	499
<b>Capital and reserves</b>				
Called up share capital		2,140	1,636	1,646
Reserves	12	19,818	13,040	10,408
<b>Total equity shareholders' funds</b>		<b>21,958</b>	<b>14,676</b>	<b>12,054</b>
		<b>42,442</b>	<b>25,099</b>	<b>34,066</b>

## **Part 4: First quarter results of BT**

### **NOTES**

#### **1. Basis of preparation**

The unaudited interim results of the group, which are not statutory accounts, have been prepared on the basis of the accounting policies as set out in the report and accounts for the year ended 31 March 2001, with the exception that deferred taxation is now stated on a full liability basis in accordance with FRS 19 "Deferred tax" in place of the partial provisioning basis formerly adopted. The deferred tax liabilities are not being discounted. The comparative figures in the profit and loss account and balance sheet have been restated. Figures for the year ended 31 March 2001 are extracts from the group accounts for that year as restated for the effects of FRS 19 and the earnings per share have been restated for the dilutionary effect of the company's rights issue which closed on 15 June 2001.

On 1 June 2001, the group disposed of its interests in Japan Telecom and J-Phone Communications and on 29 June 2001, its interest in Airtel. On 25 June 2001, the group sold Yell, its classified advertising directory businesses in the UK and the USA. These activities are shown as discontinued operations in the profit and loss accounts.

The group accounts for the year ended 31 March 2001, on which the auditors made an unqualified report which did not contain a statement under Section 237(2) or (3) of the Companies Act 1985, have been delivered to the Registrar of Companies.

#### **2. Results of businesses**

The tables below show the results of BT's current business organisation, which was put in place during the year ended 31 March 2001. Elements of the information are a restatement of the actual results of the group to show the businesses as if they had traded as separate units throughout the relevant comparative period. There is extensive trading between many of the business units and profitability is dependent on the transfer price levels. These intra-group trading arrangements have been subject to review and have changed in certain instances. Comparative figures have been restated for these and other changes and in certain instances have been determined using apportionments and allocations. Further changes to the intra-group trading arrangements may be made during the current financial year.

(a) Operating results

First quarter ended 30 June 2001

	Group turnover £m	EBITDA before exceptional items <sup>(i)</sup> £m	amortisation and exceptional items <sup>(i)</sup> £m	Share of associates and joint ventures total operating profit (loss) before goodwill amortisation and exceptional items £m
BT Retail	2,994	361	316	—
BT Wholesale	2,989	960	487	—
BT Ignite	1,016	36	(78)	(15)
BTopenworld	46	(38)	(41)	(4)
Other	104	109	14	49
Concert	—	—	—	(81)
Eliminations <sup>(iii)</sup>	(2,651)	—	—	—
<b>Total Future BT before exceptional items</b>	<b>4,498</b>	<b>1,428</b>	<b>698</b>	<b>(51)</b>
BT Wireless	1,037	64	(95)	3
Discontinued operations	171	41	37	68
Eliminations <sup>(iii)</sup>	(252)	—	—	—
<b>Total before exceptional items</b>	<b>5,454</b>	<b>1,533</b>	<b>640</b>	<b>20</b>
Exceptional items and goodwill amortisation	—	(14)	(135)	(30)
<b>Total after exceptional items</b>	<b>5,454</b>	<b>1,519</b>	<b>505</b>	<b>(10)</b>

## Part 4: First quarter results of BT

### (a) Operating results

	First quarter ended 30 June 2000 <sup>(ii)</sup>			
	Group turnover £m	EBITDA before exceptional items <sup>(i)</sup> £m	amortisation and exceptional items <sup>(i)</sup> £m	Share of associates and joint ventures total operating profit (loss) before goodwill amortisation and exceptional items £m
BT Retail	2,961	269	225	—
BT Wholesale	2,798	1,015	595	—
BT Ignite	752	(39)	(101)	(40)
BTopenworld	26	(34)	(37)	(36)
Other	56	138	53	(38)
Concert	—	—	—	60
Eliminations <sup>(iii)</sup>	(2,594)	—	—	—
<b>Total Future BT before exceptional items</b>	<b>3,999</b>	<b>1,349</b>	<b>735</b>	<b>(54)</b>
BT Wireless	764	116	45	(55)
Discontinued operations	165	53	51	154
Eliminations and other <sup>(iii)</sup>	(196)	—	—	—
<b>Total before exceptional items</b>	<b>4,732</b>	<b>1,518</b>	<b>831</b>	<b>45</b>
Exceptional items and goodwill amortisation	—	—	(76)	(41)
<b>Total after exceptional items</b>	<b>4,732</b>	<b>1,518</b>	<b>755</b>	<b>4</b>

(a) Operating results

	Year ended 31 March 2001 <sup>(ii)</sup>			
	Group turnover £m	EBITDA before exceptional items <sup>(i)</sup> £m	amortisation and exceptional items <sup>(i)</sup> £m	Share of associates and joint ventures total operating profit (loss) before goodwill amortisation and exceptional items £m
BT Retail	12,063	1,072	888	—
BT Wholesale	11,728	4,276	2,538	—
BT Ignite	3,468	50	(309)	(121)
BTopenworld	140	(198)	(233)	(59)
Other	474	592	216	(21)
Concert	—	—	—	19
Eliminations <sup>(iii)</sup>	(10,741)	—	—	—
<b>Total Future BT before exceptional items</b>	<b>17,132</b>	<b>5,792</b>	<b>3,100</b>	<b>(182)</b>
BT Wireless	3,397	356	3	(228)
Discontinued operations	749	201	188	530
Eliminations <sup>(iii)</sup>	(851)	—	—	—
<b>Total before exceptional items</b>	<b>20,427</b>	<b>6,349</b>	<b>3,291</b>	<b>120</b>
Exceptional items and goodwill amortisation	—	143	(3,230)	(517)
<b>Total after exceptional items</b>	<b>20,427</b>	<b>6,492</b>	<b>61</b>	<b>(397)</b>

Notes:

(i) Excludes associates and joint ventures.

(ii) The results of the lines of business for the quarter ended 30 June 2000 and the year ended 31 March 2001 have been restated.

(iii) Includes elimination of turnover between businesses which is included in total turnover of the originating business.

## Part 4: First quarter results of BT

### BT Retail analysis

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
<b>Group turnover</b>			
Fixed-network calls	1,155	1,238	4,966
Exchange lines	887	823	3,399
Private services	153	159	616
Customer premises equipment supply	144	152	609
Other sales and services	253	265	1,067
Sales to other BT businesses	402	324	1,406
<b>Total group turnover</b>	<b>2,994</b>	<b>2,961</b>	<b>12,063</b>
Payments to network operators and other cost of sales	2,122	2,109	8,604
Gross margin	872	852	3,459
Selling, general and administration costs	511	583	2,387
<b>EBITDA</b>	<b>361</b>	<b>269</b>	<b>1,072</b>
Depreciation	45	44	184
<b>Group operating profit before exceptional items</b>	<b>316</b>	<b>225</b>	<b>888</b>

### BT Wholesale analysis

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
<b>Group turnover</b>			
BT Retail	1,930	1,951	7,940
Other BT lines of business	192	187	783
Concert global venture	138	166	605
UK telecommunication operators	729	494	2,400
<b>Total group turnover</b>	<b>2,989</b>	<b>2,798</b>	<b>11,728</b>
<b>Operating costs</b>			
Staff costs	250	231	1,007
Own work capitalised	(127)	(127)	(563)
Payments to network operators	843	691	3,062
Payments to other BT businesses <sup>(a)</sup>	1,028	1,008	3,823
Other operating costs	101	68	327
Other operating income	(66)	(88)	(204)
<b>Total operating costs before depreciation</b>	<b>2,029</b>	<b>1,783</b>	<b>7,452</b>
<b>EBITDA</b>	<b>960</b>	<b>1,015</b>	<b>4,276</b>
Depreciation	473	420	1,738
<b>Group operating profit before exceptional items</b>	<b>487</b>	<b>595</b>	<b>2,538</b>
<i>Note:</i>			
(a) Includes payments to BT Wireless for interconnect	118	96	402



## BT Ignite analysis

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
<b>Group turnover</b>			
Syntegra	143	117	563
Ignite solutions <sup>(i)</sup>	407	343	1,566
Application service provision	18	13	72
Content hosting	20	10	62
Media distribution	68	63	257
European connectivity	225	66	471
UK IP and other	241	183	782
Eliminations	(106)	(43)	(305)
<b>Total group turnover</b>	<b>1,016</b>	<b>752</b>	<b>3,468</b>
<b>EBITDA</b>			
Syntegra	2	7	48
Ignite solutions <sup>(i)</sup>	36	23	136
Application service provision	(5)	(13)	(50)
Content hosting	(13)	(12)	(46)
Media distribution	17	21	92
European connectivity	(24)	(7)	(79)
UK IP and other	23	(58)	(51)
<b>Total EBITDA</b>	<b>36</b>	<b>(39)</b>	<b>50</b>
<b>Operating profit (loss) before goodwill amortisation and exceptional items</b>			
Syntegra	(1)	4	37
Ignite solutions <sup>(i)</sup>	17	11	61
Application service provision	(7)	(14)	(63)
Content hosting	(18)	(14)	(53)
Media distribution	12	15	66
European connectivity	(63)	(32)	(198)
UK IP and other	(18)	(71)	(159)
<b>Total operating loss before goodwill amortisation and exceptional items</b>	<b>(78)</b>	<b>(101)</b>	<b>(309)</b>

*Note:*

(i) Formerly Syncordia Solutions and strategic markets.

## Part 4: First quarter results of BT

### BT Wireless analysis

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
<b>Group turnover</b>			
UK — BT Cellnet	693	686	2,894
Germany — Viag Interkom	199	—	70
Ireland — Esat Digifone	95	67	322
The Netherlands — Telfort	40	—	91
Genie	11	—	13
Other	(1)	11	7
<b>Total group turnover</b>	<b>1,037</b>	<b>764</b>	<b>3,397</b>
<b>EBITDA</b>			
UK — BT Cellnet	166	124	554
Germany — Viag Interkom	(66)	—	(20)
Ireland — Esat Digifone	28	17	68
The Netherlands — Telfort	(17)	—	(64)
Genie	(33)	(18)	(133)
Other	(14)	(7)	(49)
<b>Total EBITDA</b>	<b>64</b>	<b>116</b>	<b>356</b>
<b>Operating profit (loss) before goodwill amortisation and exceptional items</b>			
UK — BT Cellnet	97	64	302
Germany — Viag Interkom	(123)	—	(40)
Ireland — Esat Digifone	15	7	21
The Netherlands — Telfort	(31)	—	(87)
Genie	(38)	(18)	(138)
Other	(15)	(8)	(55)
<b>Total operating profit (loss) before goodwill amortisation and exceptional items</b>	<b>(95)</b>	<b>45</b>	<b>3</b>
<b>Capital expenditure</b>			
UK — BT Cellnet	122	112	717
Germany — Viag Interkom	79	—	31
Ireland — Esat Digifone	19	36	127
The Netherlands — Telfort	37	—	111
Genie	11	12	23
Other	16	13	96
<b>Total capital expenditure</b>	<b>284</b>	<b>173</b>	<b>1,105</b>

## BT Wireless analysis

	First quarter ended June 30	
	2001 £m	2000 £m
<b>Pro forma information</b>		
<b>Group turnover</b>		
As stated	1,037	764
Viag Interkom	—	128
Telfort	—	25
Pro forma group turnover	1,037	917
<b>EBITDA</b>		
As stated	64	116
Viag Interkom	—	(85)
Telfort	—	(24)
Pro forma EBITDA	64	7
<b>Operating profit (loss) before goodwill amortisation and exceptional items</b>		
As stated	(95)	45
Viag Interkom	—	(123)
Telfort	—	(35)
Pro forma operating profit (loss)	(95)	(113)
<b>Capital expenditure</b>		
As stated	284	173
Viag Interkom	—	87
Telfort	—	32
Pro forma capital expenditure	284	292

*Note:*

Pro forma information has been provided for the three months ended 30 June 2000 to illustrate the impact of the acquisitions of Viag Interkom and Telfort as if these acquisitions had been made on 1 April 2000.

## Part 4: First quarter results of BT

### (b) Capital expenditure on plant, equipment and property

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
BT Retail	30	53	157
BT Wholesale	445	480	2,273
BT Ignite	142	133	935
BTopenworld	2	22	10
Other	86	87	482
<b>Total Future BT</b>	<b>705</b>	<b>775</b>	<b>3,857</b>
BT Wireless	284	173	1,105
Discontinued activities	1	2	24
<b>Total</b>	<b>990</b>	<b>950</b>	<b>4,986</b>

### (c) Net assets

	At 30 June 2001	
	Net operating assets (liabilities) <sup>(i)</sup> £m	Associates and joint ventures £m
BT Retail	1,246	—
BT Wholesale	12,098	—
BT Ignite	3,500	166
BTopenworld	(35)	8
Concert	—	1,348
Other	1,840	1,034
<b>Total Future BT</b>	<b>18,649</b>	<b>2,556</b>
BT Wireless	19,487	25
<b>Total</b>	<b>38,136</b>	<b>2,581</b>

	At 31 March 2001	
BT Retail	1,114	—
BT Wholesale	12,511	—
BT Ignite	3,584	178
BTopenworld	(42)	10
Concert	—	1,430
Other	1,775	2,511
<b>Total Future BT</b>	<b>18,942</b>	<b>4,129</b>
BT Wireless	18,634	27
<b>Total</b>	<b>37,576</b>	<b>4,156</b>

#### Note:

- (i) Net operating assets comprise tangible and intangible fixed assets, stocks, debtors less creditors, excluding loans and other borrowings, and provisions for liabilities and charges, excluding deferred tax.

### 3. Other operating income

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Provision of administration services to the Concert global venture	42	59	168
Other	59	29	225
<b>Total</b>	<b>101</b>	<b>88</b>	<b>393</b>

#### 4. Group's share of losses of associates and joint ventures

The results are shown after charging goodwill amortisation of £30 million (2000 — £41 million) for the three months ended 30 June 2001. The results for the year ended 31 March 2001 included £132 million for the write off of subscriber acquisition costs. The results are shown after charging goodwill amortisation of £385 million for the year ended 31 March 2001. The amortisation for the year ended 31 March 2001 included £200 million for the impairment of goodwill in ventures.

#### 5. Profit on sale of fixed asset investments and group undertakings

The profit in the three months ended 30 June 2001 is mainly attributable to the profit of £2,364 million on the sale of BT's interests in Japan Telecom and J-Phones Communications, £844 million profit on the sale of BT's interest in Airtel and £1,149 million profit on the sale of Yell, the group's classified advertising directory business. The profit in the year ended 31 March 2001 is mainly attributable to the profit of £454 million on the sale of BT's interest in sunrise communications in November 2000. In addition, a profit has been realised on the sale of BT's aeronautical and maritime business in December 2000 and a profit was realised in the initial public offering of I.Net SpA in April 2000.

#### 6. Net interest payable

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Group	515	246	1,426
Joint ventures and associates	42	56	296
Total interest payable	557	302	1,722
Interest receivable	(83)	(63)	(408)
<b>Total interest payable</b>	<b>474</b>	<b>239</b>	<b>1,314</b>

#### 7. Earnings (loss) per share

The basic earnings (loss) per share are calculated by dividing the profit (loss) attributable to shareholders by the average number of shares in issue after deducting the company's shares held by employee share ownership trusts. In calculating the diluted earnings per share, share options outstanding and other potential ordinary shares have been taken into account. The diluted loss per share is shown as the same as the basic loss per share. Comparative figures have been restated for the rights issue which closed on 15 June 2001.

## Part 4: First quarter results of BT

The average number of shares and attributable earnings (loss) in the periods were:

	First quarter ended 30 June		Year ended 31 March
	2001	2000 (restated)	2001 (restated)
	millions of shares		millions of shares
Basic	7,506	7,241	7,276
Diluted	7,567	7,395	7,383

A reconciliation of attributable earnings (loss) to attributable earnings before goodwill amortisation and exceptional items is as follows:

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Profit (loss) attributable to shareholders	4,347	306	(1,870)
Exceptional items:			
Profit on sale of group undertakings and fixed asset investments	4,484	41	619
Rates refunds relating to prior periods	—	—	193
Goodwill impairment in Viag Interkom	—	—	(3,000)
Goodwill impairment in joint ventures	—	—	(200)
Write off of subscriber acquisition costs	—	—	(139)
Write down of Viag Interkom's integrated IT systems on division of business into fixed and wireless units	—	—	(43)
Interest receivable on rates refunds	—	—	25
BT Wireless demerger costs	(14)	—	—
Goodwill amortisation	(151)	(117)	(558)
	4,319	(76)	(3,103)
Tax credit (charge) attributable	4	(12)	(22)
Minority interests	—	(22)	(21)
Net credit (charge)	4,323	(110)	(3,146)
Profit attributable to shareholders before goodwill amortisation and exceptional items	24	416	1,276
Earnings (loss) per share			
— basic	57.9p	4.2p	(25.7)p
— diluted	57.4p	4.1p	(25.7)p
Earnings per share before goodwill amortisation and exceptional items			
— basic	0.3p	5.7p	17.5p
— diluted	0.3p	5.6p	17.3p

## 8. Reconciliation of operating profit to operating cash flow

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Group operating profit	505	755	61
Depreciation and amortisation	1,014	763	6,431
Changes in working capital	(308)	(75)	(296)
Provision movements and other	43	(16)	(309)
<b>Net cash flow from operating activities</b>	<b>1,254</b>	<b>1,427</b>	<b>5,887</b>

## 9. Intangible assets

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Mobile licences	9,546	4,160	9,732
Goodwill	8,751	6,987	8,648
	<b>18,297</b>	<b>11,147</b>	<b>18,380</b>

## 10. Net debt

### (a) Analysis

	At 30 June		At 31 March
	2001 £m	2000 £m	2001 £m
Long-term loans and other borrowings falling due after more than one year	17,633	6,736	18,775
Short-term borrowings and long-term loans and other borrowings falling due within one year	10,990	11,538	12,136
<b>Total debt</b>	<b>28,623</b>	<b>18,274</b>	<b>30,911</b>
Short-term investments	(10,754)	(2,575)	(2,557)
Cash at bank	(388)	(345)	(412)
<b>Net debt at end of period</b>	<b>17,481</b>	<b>15,354</b>	<b>27,942</b>

### (b) Reconciliation of net cash flow to movement in net debt

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Net debt at beginning of period	27,942	8,700	8,700
Increase (decrease) in net debt resulting from cash flows	(10,659)	5,974	18,942
Net debt assumed or issued on acquisitions	(15)	35	48
Currency and other movements	(147)	561	26
Other non-cash movements	360	84	226
<b>Net debt at end of period</b>	<b>17,481</b>	<b>15,354</b>	<b>27,942</b>

## Part 4: First quarter results of BT

### 11. Provisions for liabilities and charges

	At 30 June		At
	2001	2000 (restated)	31 March 2001 (restated)
	£m	£m	£m
Deferred taxation	2,290	2,378	2,285
Pension provisions	363	664	335
Other provisions	116	66	118
	<b>2,769</b>	<b>3,108</b>	<b>2,738</b>

Following the adoption of FRS 19 on 1 April 2001, the deferred tax provision has been restated to a full liability provision method and has increased on restatement by £2,015 million at 31 March 2001 and by £1,970 million at 30 June 2000.

### 12. Share capital and reserves

	£m
<b>Share capital</b>	
Balance at 1 April 2001	1,646
Rights issue <sup>(a)</sup>	494
Balance at 30 June 2001	2,140
<b>Reserves</b>	
Balance at 1 April 2001, as reported	12,423
Less: adjustment for restatement of deferred tax provision	(2,015)
Balance at 1 April 2001, as restated	10,408
Share premium on rights issue, less £52m expenses <sup>(a)</sup>	5,382
Profit for the three months to 30 June 2001	4,347
Currency movements <sup>(b)</sup>	(331)
Movement relating to BT's employee share ownership trust	(2)
Other movements	14
Balance at 30 June 2001	19,818
<b>Total share capital and reserves at 30 June 2001</b>	<b>21,958</b>

#### Notes:

- (a) The group's rights issue closed on 15 June 2001. A total of 1,976 million ordinary shares of 25 pence were issued at 300 pence per share in a 3 for 10 rights issue bringing the total number of issued ordinary shares to 8,561 million at 30 June 2001. Of the total of £5,876 million raised, net of £52 million expenses, £494 million has been credited to share capital and the balance to share premium account.
- (b) Net of £151 million movement on the retranslation of foreign borrowings and other hedging instruments.

### 13. Esat Telecom Group

On 30 March 2000, BT obtained control of the Esat Telecom Group for approximately £1.5 billion. Esat operates a fixed line telecommunications network in Ireland. BT also gained control over Esat Digifone, Ireland's second mobile operator, through Esat's 49.5 per cent interest in the company and an additional 1.0 per cent. interest acquired by the BT Group in January 2000. The majority of the consideration for the Esat Telecom Group was paid in April 2000.

In February 2001, Telenor, the owner of the remaining 49.5 per cent interest in Esat Digifone, decided to sell this interest to BT under an agreement made in January 2000. The transaction was completed on 18 April 2001 for approximately £869 million including acquisition expenses.



#### 14. Earnings before interest, taxation, depreciation and amortisation (EBITDA)

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Group operating profit	505	755	61
Depreciation	887	687	3,045
Amortisation	127	76	3,386
EBITDA	1,519	1,518	6,492
Exceptional items excluding depreciation and amortisation	14	—	(143)
EBITDA before exceptional items	1,533	1,518	6,349

#### 15. Results of associates and joint ventures

	Turnover £m	EBITDA before exceptional items £m	Total operating profit (loss) before goodwill amortisation and exceptional items £m
<b>Group's share</b>			
<i>First quarter ended 30 June 2001</i>			
Concert global venture	600	(33)	(81)
Cegetel	252	72	44
Other continuing	279	22	(11)
Discontinued investments	634	148	68
<b>Total</b>	1,765	209	20
<i>First quarter ended 30 June 2000</i>			
Concert global venture	594	99	60
Cegetel	192	(3)	4
Other continuing	468	(96)	(173)
Discontinued investments	968	162	154
<b>Total</b>	2,222	162	45
<i>Year ended 31 March 2001</i>			
Concert global venture	2,576	170	19
Cegetel	860	196	90
Other continuing	1,673	(247)	(519)
Discontinued investments	4,828	1,077	530
<b>Total</b>	9,937	1,196	120

## Part 4: First quarter results of BT

### 16. United States Generally Accepted Accounting Principles

The results set out above have been prepared in accordance with accounting principles generally accepted in the United Kingdom. The table below sets out the results calculated in accordance with United States Generally Accepted Accounting Principles.

	First quarter ended 30 June		Year ended 31 March
	2001 £m	2000 £m	2001 £m
Net income (loss) attributable to shareholders	<b>3,752</b>	240	(2,357)
Earnings (loss) per ADS (£)	<b>5.00</b>	0.33	(3.63)

Each American Depositary Share (ADS) represents 10 ordinary shares of 25p each.

Shareholders' equity, calculated in accordance with United States Generally Accepted Accounting Principles, is £18,894 million at 30 June 2001 (30 June 2000 — £13,553 million, 31 March 2001 — £10,231 million).

## Non-financial statistics

As at 30 June 2001, unless otherwise stated

### BT Wireless — selected operations

#### BT Cellnet: (000s)

Pre-pay customer base	7,455
Post-pay customer base	3,435
Total customer base	10,890
2½12 generation and WAP customers	788

#### ARPU

	Network (£ per year)	Group (£ per year)
Pre-pay ARPU	110	110
Post-pay ARPU	529	486
Blended ARPU	267	251

#### Viag Interkom: (000s)

Pre-pay customer base	1,654
Post-pay customer base	1,724
Total customer base	3,378
2½12 generation and WAP customers	239

(£ per year)

Pre-pay ARPU	79
Post-pay ARPU	304
Blended ARPU	204

#### Esat Digifone: (000s)

Pre-pay customer base	655
Post-pay customer base	342
Total customer base	997
2½12 generation and WAP customers	38

(£ per year)

Pre-pay ARPU	224
Post-pay ARPU	625
Blended ARPU	370

#### Telfort: (000s)

Pre-pay customer base	636
Post-pay customer base	199
Total customer base	835

(£ per year)

Pre-pay ARPU	81
Post-pay ARPU	472
Blended ARPU	158

#### Notes:

- (i) Customer bases are active customers. Pre-pay customers are defined as active if they have used the network by sending or receiving a call within the last three months.
- (ii) ARPU is the annual average revenue per user. Both Group ARPU and Network ARPU is shown for BT Cellnet.

## Part 4: First quarter results of BT

As at 30 June 2001, unless otherwise stated

Group	(000s)
UK exchange lines:	
Business, including wholesale	8,963
Residential, including service providers	20,028
<b>BT Wholesale</b>	
Optical fibre in network (km millions)	5.4
SDH nodes	2,123
Next generation trunk switches	59
BT Dial IP ports connected to groomed local exchanges (000s) <sup>(a)</sup>	305
ADSL enabled exchanges	890
ADSL lines provided (000s)	68

*Note:*

- (a) Grooming applies to internet type calls originating from BT customers. These calls are grouped together and then routed directly to BT's Dial IP platform or other operators' networks. Grooming occurs at all BT's digital local exchanges.

### BT Ignite

Inter-city fibre network (kms)	52,000
Web hosting centres	22
Dial access ports	480,000

### BTopenworld

Fixed ISP UK customers:	(000s)
Pay As You Go	551
ISP Customers (unmetered)	761
Total	1,312
ADSL customers	37

### Forward-looking statements — caution advised

Certain statements in this results release are forward-looking and are made in reliance on the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995. These statements include, without limitation, those concerning: expectations regarding turnover, costs, growth and the communications industry; the possible or assumed future results of operations of BT and/or its associates and joint ventures; the impact on BT of Concert, the global venture with AT&T; expectations regarding capital expenditure and investment plans; expectations regarding the disposal of non-core businesses and group property, intentions regarding the demerger of BT Wireless and the level of BT's borrowings.

Although BT believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to have been correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements.

Factors that could cause differences between actual results and those implied by the forward-looking statements include, but are not limited to: material adverse changes in economic conditions in the markets served by BT and its new businesses; future regulatory actions and conditions in BT's operating areas, including competition from others in the UK and other international communications markets; technological innovations, including the cost of developing new products and the need to increase expenditure improving the quality of service; prolonged adverse weather conditions resulting in a material increase in overtime, staff or other costs; developments in the convergence of technologies; the timing of entry and profitability of BT, its new businesses and Concert in certain national and international markets; fluctuations in foreign currency exchange rates and interest rates; general financial market conditions affecting BT's ability to fulfil its intentions regarding BT Wireless and its debt reduction."

# Part 5: Financial information on BT and BT Group

## 1. Accountants' report on BT Group plc



**PricewaterhouseCoopers LLP**  
1 Embankment Place  
London WC2N 6RH

The Directors  
BT Group plc  
BT Centre  
81 Newgate Street  
London  
EC1A 7AJ

The Directors  
Cazenove & Co. Ltd  
12 Tokenhouse Yard  
London  
EC2R 7AJ

18 September 2001

Dear Sirs

### **BT Group plc**

#### **Introduction**

We report on the financial information set out below. This financial information has been prepared for inclusion in the listing particulars dated 18 September 2001 (“the Listing Particulars”) of BT Group plc (“the Company”).

The Company was incorporated as Newgate Telecommunications Limited on 30 March 2001 and was re-registered as a public limited company and changed its name to BT Group plc by special resolution on 10 September 2001. The Company has not yet commenced to trade, has prepared no financial statements for presentation to its members and has not declared or paid a dividend.

#### **Basis of preparation**

The financial information set out below is based on the financial records of the Company, to which no adjustment was considered necessary.

#### **Responsibility**

The financial records are the responsibility of the directors of the Company.

The directors of the Company are responsible for the contents of the Listing Particulars in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial records, to form an opinion on the financial information and to report our opinion to you.

#### **Basis of opinion**

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. Our work also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial records underlying the financial information and whether the accounting policies are appropriate to the circumstances of the Company and adequately disclosed.

## Part 5: Financial information on BT and BT Group

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement, whether caused by fraud or other irregularity or error.

### Opinion

In our opinion, the financial information gives, for the purposes of the Listing Particulars, a true and fair view of the state of affairs of the Company as at the date stated.

### Financial information

The balance sheet of the Company at 30 June 2001 is as follows:

	Notes	£
<b>Current assets</b>		
Debtors		2
<b>Net assets</b>		<b>2</b>
Represented by:		
<b>Share capital</b>	2	<b>2</b>

### Notes to the financial information

#### Accounting policies

1. The balance sheet has been prepared in accordance with the historical cost convention.

#### Share capital

2. The Company was incorporated as Newgate Telecommunications Limited, a private limited company, on 30 March 2001 with an authorised share capital of £100, comprising 100 ordinary shares of £1 each. It was re-registered as a public limited company and adopted the name BT Group plc by special resolution on 10 September 2001. On 10 September 2001, a further 44 ordinary shares of £1 each were allotted and issued, and the authorised share capital was increased to £23,000,050,025 by the creation of 22,999,999,900 further ordinary shares and one redeemable preference share of £50,025. By an ordinary resolution of the shareholders dated 10 September 2001, the 23 billion ordinary shares of £1 each were consolidated and subdivided into 20 billion ordinary shares of 115 pence each. The redeemable preference share was allotted and treated as paid up in full on 10 September 2001.

#### Subsequent events

3. On 18 September 2001, the Company entered into a demerger agreement with British Telecommunications public limited company ("BT"), and mmO<sub>2</sub> plc which sets out the obligations of the parties in implementing the steps to achieve the proposed demerger of the mmO<sub>2</sub> business from BT.

On 18 September 2001, the Company entered into a separation agreement with BT, mmO<sub>2</sub> plc and O<sub>2</sub> Limited which sets out to allocate assets and liabilities between the parties.

On 18 September 2001, the Company entered into a tax agreement with mmO<sub>2</sub> plc, which contains provisions relating to among other things, the allocation of tax liabilities between the BT Group and the mmO<sub>2</sub> Group.

Yours faithfully

PricewaterhouseCoopers  
Chartered Accountants

## **2. Comparative table on BT Group**

### **Introduction**

The financial information in the comparative table has been prepared under the historical cost convention and in accordance with applicable accounting standards and the provisions of the Companies Act 1985. The information has been extracted without material adjustment from the published audited group financial statements of BT for the three years ended 31 March 2001, except that earnings, loss and dividend per share information in the comparative tables and related supporting notes have been restated for the dilutive effect of BT's Rights Issue which closed on 15 June 2001. Additional information in the tables has been represented for the BT Group and discontinued operations. The discontinued operations comprise mmO<sub>2</sub> which is the subject of the Demerger, the Yell line of business which was sold in June 2001, and the former equity investments in Japan Telecom, J-Phone and Airtel which were also sold in June 2001.

BT's financial statements for the year ended 31 March 2001, save for the restatement of earnings, loss and dividend per share information as discussed above, were approved by its Board on 22 May 2001. Significant events which have occurred subsequent to this approval date are summarised in the Financial Review (see Part 3) and also, for those events occurring before 26 July 2001, in BT's first quarter results announcement reproduced in Part 4.

### **Accounting policies**

#### **I Basis of preparation of the financial information**

The group financial statements consolidate those of the company and all of its subsidiary undertakings (with one minor exception – see note 20). Where the financial statements of subsidiary undertakings, associates and joint ventures do not conform with the group's accounting policies, appropriate adjustments are made on consolidation in order to present the group financial statements on a consistent basis. The principal subsidiary undertakings' financial years are all coterminous with those of the company, with the exception of one newly acquired group at 31 March 2001.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reporting period. Actual results could differ from those estimates. Estimates are used principally when accounting for income, provision for doubtful debts, payments to telecommunication operators, depreciation, employee pension schemes and taxes.

#### **II Turnover**

Group turnover, which excludes value added tax and other sales taxes, comprises the value of services provided and equipment sales by group undertakings, excluding those between them.

Total turnover is group turnover together with the group's share of its associates' and joint ventures' turnover, excluding the group's share of transactions between the group and its principal joint venture, Concert BV.

Turnover from calls is recognised in the group profit and loss account at the time the call is made over the group's networks. Turnover from rentals is recognised evenly over the period to which the charges relate. Turnover from sales is recognised at the point of sale. Prepaid call card sales are deferred until the customer uses the stored value in the card to pay for the relevant calls. Turnover from classified directories, mainly comprising advertising revenue, is recognised in the group profit and loss account upon completion of delivery. Turnover arising from the provision of other services, including maintenance contracts, is recognised evenly over the periods in which the service is provided to the customer.

#### **III Research and development**

Expenditure on research and development is written off as incurred.

#### **IV Interest**

Interest payable, including that related to financing the construction of tangible fixed assets, is written off as incurred. Discounts or premiums and expenses on the issue of debt securities are amortised over the term of the related security and included within interest payable. Premiums payable on early redemptions of debt securities, in lieu of future interest costs, are written off when paid.

## Part 5: Financial information on BT and BT Group

### V Foreign currencies

On consolidation, assets and liabilities of foreign undertakings are translated into sterling at year-end exchange rates. The results of foreign undertakings are translated into sterling at average rates of exchange for the year.

Exchange differences arising from the retranslation at year-end exchange rates of the net investment in foreign undertakings, less exchange differences on borrowings which finance or provide a hedge against those undertakings, are taken to reserves and are reported in the statement of total recognised gains and losses.

All other exchange gains or losses are dealt with through the profit and loss account.

### VI Intangibles

#### (a) Goodwill

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired.

For acquisitions completed on or after 1 April 1998, the goodwill arising is capitalised as an intangible asset or, if arising in respect of an associate or joint venture, recorded as part of the related investment. In most cases, the goodwill is amortised on a straight line basis from the time of acquisition over its useful economic life. Where special circumstances exist such that amortising goodwill over a finite period would not give a true and fair view, that goodwill is not amortised. The economic life is normally presumed to be a maximum of 20 years.

For acquisitions on or before 31 March 1998, the goodwill is written off on acquisition against group reserves.

If an undertaking is subsequently divested, the appropriate unamortised goodwill or goodwill written off to reserves is dealt with through the profit and loss account in the period of disposal as part of the gain or loss on divestment.

#### (b) Other intangibles

Licence fees paid to governments, which permit telecommunication activities to be operated for defined periods, are amortised from the later of the start of the licence period or launch of service to the end of the licence period on a straight line basis.

### VII Tangible fixed assets

Tangible fixed assets are stated at historical cost less depreciation.

#### (a) Cost

Cost in the case of network services includes contractors' charges and payments on account, materials, direct labour and directly attributable overheads.

#### (b) Depreciation

Depreciation is provided on tangible fixed assets on a straight line basis from the time they are available for use, so as to write off their costs over their estimated useful lives taking into account any expected residual values. No depreciation is provided on freehold land.

The lives assigned to other significant tangible fixed assets are:

Freehold buildings —	40 years
Leasehold land and buildings —	Unexpired portion of lease or 40 years, whichever is the shorter
Transmission equipment:	
duct —	25 years
cable —	3 to 25 years
radio and repeater equipment —	2 to 25 years
Exchange equipment —	2 to 13 years
Computers and office equipment —	2 to 6 years
Payphones, other network equipment, motor vehicles and cables —	2 to 20 years



## **VIII Fixed asset investments**

Investments in subsidiary undertakings, associates and joint ventures are stated in the balance sheet of the company at cost less amounts written off. Amounts denominated in foreign currency are translated into sterling at year-end exchange rates.

Investments in associates and joint ventures are stated in the group balance sheet at the group's share of their net assets, together with any attributable unamortised goodwill on acquisitions arising on or after 1 April 1998.

The group's share of profits less losses of associates and joint ventures is included in the group profit and loss account.

Investments in other participating interests and other investments are stated at cost less amounts written off.

## **IX Asset impairment**

Intangible and tangible fixed assets are tested for impairment when an event that might affect asset values has occurred.

An impairment loss is recognised to the extent that the carrying amount cannot be recovered either by selling the asset or by the discounted future earnings from operating the assets.

## **X Stocks**

Stocks mainly comprise items of equipment, held for sale or rental, consumable items and work in progress on long-term contracts.

Equipment held and consumable items are stated at the lower of cost and estimated net realisable value, after provisions for obsolescence.

Work in progress on long-term contracts is stated at cost, after deducting payments on account, less provisions for any foreseeable losses.

## **XI Debtors**

Debtors are stated in the balance sheet at estimated net realisable value. Net realisable value is the invoiced amount less provisions for bad and doubtful debtors. Provisions are made specifically against debtors where there is evidence of a dispute or an inability to pay. An additional provision is made based on an analysis of balances by age, previous losses experienced and general economic conditions.

## **XII Redundancy costs**

Redundancy costs arising from periodic reviews of staff levels are charged against profit in the year in which employees agree to leave the group.

If the most recent actuarial valuation of the group's pension scheme shows a deficit, which exceeds the amount of provision for pension liabilities in the balance sheet, the estimated cost of providing incremental pension benefits in respect of employees leaving the group is charged against profit in the year in which the employees agree to leave the group, within redundancy charges.

## **XIII Pension scheme**

The group operates a funded defined benefit pension scheme, which is independent of the group's finances, for the substantial majority of its employees. Actuarial valuations of the scheme are carried out as determined by the trustees at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

The cost of providing pensions is charged against profits over employees' working lives with the group using the projected unit method. Variations from this regular cost are allocated on a straight-line basis over the average remaining service lives of current employees to the extent that these variations do not relate to the estimated cost of providing incremental pension benefits in the circumstances described in XII above.

Interest is accounted for on the provision in the balance sheet which results from differences between amounts recognised as pension costs and amounts funded. The regular pension cost, variations from the regular pension cost, described above, and interest are all charged within staff costs.

## **Part 5: Financial information on BT and BT Group**

### **XIV Taxation**

The charge for taxation is based on the profit for the year and takes into account deferred taxation. Provision is made for deferred taxation only to the extent that timing differences are expected to reverse in the foreseeable future, with the exception of timing differences arising on pension costs where full provision is made irrespective of whether they are expected to reverse in the foreseeable future.

### **XV Financial instruments**

#### **(a) Debt instruments**

Debt instruments are stated at the amount of net proceeds adjusted to amortise any discount evenly over the term of the debt, and further adjusted for the effect of currency swaps acting as hedges.

#### **(b) Derivative financial instruments**

The group uses derivative financial instruments to reduce exposure to foreign exchange risks and interest rate movements. The group does not hold or issue derivative financial instruments for financial trading purposes.

#### **Criteria to qualify for hedge accounting**

The group considers its derivative financial instruments to be hedges when certain criteria are met. For foreign currency derivatives, the instrument must be related to actual foreign currency assets or liabilities or a probable commitment and whose characteristics have been identified. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the group's operations. For interest rate derivatives, the instrument must be related to assets or liabilities or a probable commitment, such as a future bond issue, and must also change the interest rate or the nature of the interest rate by converting a fixed rate to a variable rate or vice versa.

#### **Accounting for derivative financial instruments**

Principal amounts underlying currency swaps are revalued at exchange rates ruling at the date of the group balance sheet and, to the extent that they are not related to debt instruments, are included in debtors or creditors.

Interest differentials, under interest rate swap agreements used to vary the amounts and periods for which interest rates on borrowings are fixed, are recognised by adjustment of interest payable.

The forward exchange contracts used to change the currency mix of net debt are revalued to balance sheet rates with net unrealised gains and losses being shown as part of debtors, creditors, or as part of net debt. The difference between spot and forward rate for these contracts is recognised as part of net interest payable over the term of the contract.

The forward exchange contracts hedging transaction exposures are revalued at the prevailing forward rate on the balance sheet date with net unrealised gains and losses being shown as debtors and creditors.

Instruments that form hedges against future fixed-rate bond issues are marked to market. Gains or losses are deferred until the bond is issued when they are recognised evenly over the term of the bond.

**Group profit and loss account**  
for the year ended 31 March 2001

	Notes	Business performance				BT Group £m	Discontinued activities and intercompany eliminations £m	BT total £m
		Before goodwill amortisation, exceptional items and acquisitions £m	Acquisitions £m	Total before goodwill amortisation and exceptional items £m	Goodwill amortisation and exceptional items £m			
<b>Total turnover</b>	3	26,969	2,697	29,666	—	<b>21,063</b>	8,603	29,666
Group's share of joint ventures' turnover	3	(4,016)	(2)	(4,018)	—	<b>(3,456)</b>	(562)	(4,018)
Group's share of associates' turnover	3	(3,557)	(2,362)	(5,919)	—	<b>(1,175)</b>	(4,744)	(5,919)
Trading between group and principal joint venture	3	698	—	698	—	<b>698</b>	—	698
<b>Group turnover</b>	3	20,094	333	20,427	—	<b>17,130</b>	3,297	20,427
Other operating income	4	393	—	393	—	<b>393</b>	—	393
Operating costs	5	(16,996)	(533)	(17,529)	(3,230)	<b>(14,500)</b>	(6,259)	(20,759)
Group operating profit (loss)		3,491	(200)	3,291	(3,230)	<b>3,023</b>	(2,962)	61
Group's share of operating loss of joint ventures	6	(474)	(8)	(482)	(284)	<b>(508)</b>	(258)	(766)
Group's share of operating profit (loss) of associates	6	356	246	602	(233)	<b>(24)</b>	393	369
Total operating profit (loss)		3,373	38	3,411	(3,747)	<b>2,491</b>	(2,827)	(336)
Profit on sale of fixed asset investments	7	—	—	—	535	<b>535</b>	—	535
Profit on sale of group undertakings	7	—	—	—	84	<b>84</b>	—	84
Interest receivable	8	379	4	383	25	<b>494</b>	(86)	408
Interest payable	9	(1,622)	(100)	(1,722)	—	<b>(1,528)</b>	(194)	(1,722)
<b>Profit (loss) on ordinary activities before taxation</b>		2,130	(58)	2,072	(3,103)	<b>2,076</b>	(3,107)	(1,031)
Tax on profit (loss) on ordinary activities	10	(562)	(68)	(630)	(22)	<b>(508)</b>	(144)	(652)
<b>Profit (loss) on ordinary activities after taxation</b>		1,568	(126)	1,442	(3,125)	<b>1,568</b>	(3,251)	(1,683)
Minority interests	11	(27)	(79)	(106)	(21)	<b>2</b>	(129)	(127)
<b>Profit (loss) for the financial year</b>		1,541	(205)	1,336	(3,146)	<b>1,570</b>	(3,380)	(1,810)
Dividends	12							(571)
<b>Transfer from reserves for the financial year</b>	27							<b>(2,381)</b>
<b>Basic earnings (loss) per share (restated)</b>	13	21.1p	(2.8)p	18.3p	(43.2)p	<b>21.6p</b>	(46.5)p	(24.9)p
<b>Diluted earnings (loss) per share (restated)</b>	13	20.9p	(2.8)p	18.1p	(43.3)p	<b>21.3p</b>	(46.2)p	(24.9)p

## Part 5: Financial information on BT and BT Group

### Group profit and loss account for the year ended 31 March 2000

	Business performance					BT Group £m	Discontinued activities and intercompany eliminations £m	BT total £m
	Notes	Before goodwill amortisation, exceptional items and acquisitions £m	Acquisitions £m	Total before goodwill amortisation and exceptional items £m	Goodwill amortisation and exceptional items £m			
<b>Total turnover</b>	3	20,972	931	21,903	—	<b>18,228</b>	3,675	21,903
Group's share of joint ventures' turnover	3	(1,784)	—	(1,784)	—	<b>(1,387)</b>	(397)	(1,784)
Group's share of associates' turnover	3	(936)	(644)	(1,580)	—	<b>(892)</b>	(688)	(1,580)
Trading between group and principal joint venture	3	176	—	176	—	<b>176</b>	—	176
<b>Group turnover</b>	3	18,428	287	18,715	—	<b>16,125</b>	2,590	18,715
Other operating income	4	243	(1)	242	—	<b>242</b>	—	242
Operating costs	5	(14,868)	(291)	(15,159)	(200)	<b>(12,985)</b>	(2,374)	(15,359)
Group operating profit (loss)		3,803	(5)	3,798	(200)	<b>3,382</b>	216	3,598
Group's share of operating loss of joint ventures	6	(399)	—	(399)	(28)	<b>(211)</b>	(216)	(427)
Group's share of operating profit (loss) of associates	6	57	26	83	(56)	<b>(2)</b>	29	27
Total operating profit		3,461	21	3,482	(284)	<b>3,169</b>	29	3,198
Profit on sale of fixed asset investments	7	—	—	—	—	<b>—</b>	—	—
Profit on sale of group undertakings	7	—	—	—	126	<b>126</b>	—	126
Interest receivable	8	188	5	193	—	<b>211</b>	(18)	193
Interest payable	9	(545)	(30)	(575)	—	<b>(542)</b>	(33)	(575)
<b>Profit (loss) on ordinary activities before taxation</b>		3,104	(4)	3,100	(158)	<b>2,964</b>	(22)	2,942
Tax on profit (loss) on ordinary activities	10	(869)	(23)	(892)	(5)	<b>(827)</b>	(70)	(897)
<b>Profit (loss) on ordinary activities after taxation</b>		2,235	(27)	2,208	(163)	<b>2,137</b>	(92)	2,045
Minority interests	11	11	(1)	10	—	<b>9</b>	1	10
<b>Profit (loss) for the financial year</b>		2,246	(28)	2,218	(163)	<b>2,146</b>	(91)	2,055
Dividends	12							(1,426)
<b>Retained profit for the financial year</b>	27							629
<b>Basic earnings (loss) per share (restated)</b>	13	31.1p	(0.4)p	30.7p	(2.3)p	<b>29.7p</b>	(1.3)p	28.4p
<b>Diluted earnings (loss) per share (restated)</b>	13	30.3p	(0.4)p	29.9p	(2.3)p	<b>29.0p</b>	(1.3)p	27.7p

**Group profit and loss account**  
for the year ended 31 March 1999

	Notes	Business performance		BT Group £m	Discontinued activities and intercompany eliminations £m	BT total £m
		Before goodwill amortisation, exceptional items and acquisitions £m	Goodwill amortisation and exceptional items £m			
<b>Total turnover</b>	3	18,223	—	<b>16,186</b>	2,037	<b>18,223</b>
Group's share of joint ventures' turnover	3	(561)	—	(398)	(163)	(561)
Group's share of associates' turnover	3	(709)	—	(591)	(118)	(709)
Trading between group and principal joint venture	3	—	—	—	—	—
<b>Group turnover</b>	3	16,953	—	<b>15,197</b>	1,756	<b>16,953</b>
Other operating income	4	168	—	168	—	168
Operating costs	5	(13,236)	(69)	(11,910)	(1,395)	(13,305)
Group operating profit		3,885	(69)	3,455	361	3,816
Group's share of operating loss of joint ventures	6	(330)	(12)	(208)	(134)	(342)
Group's share of operating profit (loss) of associates	6	5	(5)	(6)	6	—
Total operating profit		3,560	(86)	3,241	233	3,474
Profit on sale of fixed asset investments	7	—	1,107	1,107	—	1,107
Profit on sale of group undertakings	7	—	—	—	—	—
Interest receivable	8	165	—	180	(15)	165
Interest payable	9	(451)	—	(441)	(10)	(451)
<b>Profit on ordinary activities before taxation</b>		3,274	1,021	<b>4,087</b>	208	<b>4,295</b>
Tax on profit on ordinary activities	10	(1,002)	(291)	(1,197)	(96)	(1,293)
<b>Profit on ordinary activities after taxation</b>		2,272	730	<b>2,890</b>	112	<b>3,002</b>
Minority interests	11	(19)	—	13	(32)	(19)
Profit for the financial year		2,253	730	<b>2,903</b>	80	<b>2,983</b>
Dividends	12					(1,322)
<b>Retained profit for the financial year</b>	27					<b>1,661</b>
<b>Basic earnings per share (restated)</b>	13	31.3p	10.2p	<b>40.4p</b>	1.1p	<b>41.5p</b>
<b>Diluted earnings per share (restated)</b>	13	30.7p	9.9p	<b>39.5p</b>	1.1p	<b>40.6p</b>

**Group statement of total recognised gains and losses**  
for the three years ended 31 March 2001

	2001 £m	2000 £m	1999 £m
Profit (loss) for the financial year:			
Group	(915)	2,576	3,362
Joint ventures	(974)	(480)	(362)
Associates	79	(41)	(17)
Total profit (loss) for the financial year	<b>(1,810)</b>	2,055	2,983
Currency movements arising on consolidation of non-UK:			
Subsidiaries	215	(27)	3
Joint ventures	245	(141)	27
Associates	(31)	102	15
Unrealised gain (loss) on transfer of assets and group undertakings to a joint venture	(49)	159	—
<b>Total recognised gains and losses for the financial year</b>	<b>(1,430)</b>	2,148	3,028

## Part 5: Financial information on BT and BT Group

### Group cash flow statements

for the three years ended 31 March 2001

	Notes	2001 £m	2000 £m	1999 £m
<b>Net cash inflow from operating activities</b>	14	<b>5,887</b>	5,849	6,035
<b>Dividends from associates and joint ventures</b>		<b>10</b>	5	2
<b>Returns on investments and servicing of finance</b>				
Interest received		293	286	111
Interest paid, including finance costs		(1,020)	(449)	(439)
<b>Net cash outflow for returns on investments and servicing of finance</b>		<b>(727)</b>	(163)	(328)
<b>Taxation</b>				
UK corporation tax paid		(669)	(1,308)	(359)
Windfall tax paid		—	—	(255)
Non-UK tax paid		—	(3)	(16)
<b>Taxation paid</b>		<b>(669)</b>	(1,311)	(630)
<b>Capital expenditure and financial investment</b>				
Purchase of intangible fixed assets		(4,208)	—	—
Purchase of tangible fixed assets		(4,756)	(3,568)	(3,220)
Sale of tangible fixed assets		440	143	143
Purchase of fixed asset investments		(93)	(373)	(103)
Disposal of fixed asset investments		175	46	4,226
<b>Net cash inflow (outflow) for capital expenditure and financial investment</b>		<b>(8,442)</b>	(3,752)	1,046
<b>Acquisitions and disposals</b>				
Purchase of subsidiary undertakings, net of £101 million cash acquired (2000 — £69 million cash acquired, 1999 — £5 million overdraft)		(11,215)	(4,065)	(672)
Investments in joint ventures		(3,214)	(933)	(1,038)
Investments in associates		(72)	(2,167)	(288)
Repayment of loan to joint venture		—	550	—
Disposal of subsidiary undertakings		245	206	14
Sale of investments in joint ventures and associates		502	4	17
<b>Net cash outflow for acquisitions and disposals</b>		<b>(13,754)</b>	(6,405)	(1,967)
<b>Equity dividends paid</b>		<b>(1,432)</b>	(1,364)	(1,186)
Cash inflow (outflow) before management of liquid resources and financing		(19,127)	(7,141)	2,972
<b>Management of liquid resources</b>	15	<b>(480)</b>	1,236	(2,447)
<b>Financing</b>				
Issue of ordinary share capital		149	127	161
Issue of shares to minorities		36	432	13
New loans		14,552	1,473	10
Repayment of loans		(225)	(587)	(457)
Net increase (decrease) in short-term borrowings		5,223	4,514	(185)
<b>Net cash inflow (outflow) from financing</b>		<b>19,735</b>	5,959	(458)
<b>Increase in cash in the year</b>		<b>128</b>	54	67
<b>Decrease (increase) in net debt in the year</b>	17	<b>(18,942)</b>	(6,582)	3,146

## Balance sheets

at 31 March 2001, 2000 and 1999

	Notes	2001 £m	2000 £m	1999 £m
<b>Fixed assets</b>				
Intangible assets	18	18,380	5,777	742
Tangible assets	19	21,625	18,163	17,854
Investments in joint ventures:	20			
Share of gross assets and goodwill		5,439	3,631	1,857
Share of gross liabilities		(3,512)	(1,045)	(775)
		1,927	2,586	1,082
Investments in associates	20	2,229	2,639	418
Other investments	20	1,048	653	332
Total investments	20	5,204	5,878	1,832
<b>Total fixed assets</b>		<b>45,209</b>	<b>29,818</b>	<b>20,428</b>
<b>Current assets</b>				
Stocks		361	225	159
Debtors	21	6,260	5,241	3,995
Investments	22	2,557	2,051	3,278
Cash at bank and in hand		412	253	102
<b>Total current assets</b>		<b>9,590</b>	<b>7,770</b>	<b>7,534</b>
<b>Creditors: amounts falling due within one year</b>				
Loans and other borrowings	23	12,136	5,650	947
Other creditors	24	8,597	9,235	7,082
<b>Total creditors: amounts falling due within one year</b>		<b>20,733</b>	<b>14,885</b>	<b>8,029</b>
<b>Net current liabilities</b>		<b>(11,143)</b>	<b>(7,115)</b>	<b>(495)</b>
<b>Total assets less current liabilities</b>		<b>34,066</b>	<b>22,703</b>	<b>19,933</b>
<b>Creditors: amounts falling due after more than one year</b>				
Loans and other borrowings	23	18,775	5,354	3,386
<b>Provisions for liabilities and charges</b>	25	<b>723</b>	1,056	1,391
<b>Minority interests</b>		<b>499</b>	498	216
<b>Capital and reserves</b>				
Called up share capital	26	1,646	1,627	1,617
Share premium account	27	2,195	1,580	1,206
Other reserves	27	884	933	774
Profit and loss account	27	9,344	11,655	11,343
<b>Total equity shareholders' funds</b>	27	<b>14,069</b>	<b>15,795</b>	<b>14,940</b>
		<b>34,066</b>	<b>22,703</b>	<b>19,933</b>

## Part 5: Financial information on BT and BT Group

### Notes to the financial information

#### 1. Changes in accounting policies and presentation

With effect from 1 April 2000, the group changed its method of accounting for loans and other borrowings. Loans and other borrowings are now adjusted for the effect of currency swaps acting as hedges. There is no impact on the profit of the group as a result of this change; the adjustment is reflected in debtors or creditors. By adjusting for the effects of currency swaps acting as hedges the balances stated reflect the full economic exposure of the company arising from loans and other borrowings. The comparative figures have not been restated as the impact is not material.

During the year ended 31 March 2001, the group has made a number of changes in the presentation of its financial statements. Comparative figures have been restated accordingly. These are explained in the notes where material.

#### 2. Segmental analysis

The group provides telecommunication services, principally in the UK and essentially operated as a unitary business prior to 1 July 2000. Its main services and products are fixed voice and data calls in the UK, the provision of fixed exchange lines to homes and businesses, the supply of mobile communication services and equipment to businesses and individuals, the provision of communication services in the UK to other operators, the provision of private services to businesses and the supply of telecommunication equipment for customers' premises.

In April 2000, the group announced a restructuring whereby the group and its associates and joint ventures would be managed in several separate lines of business comprising four international businesses and two UK operating businesses, together with the group's Concert global venture. The four international businesses, which were formed in July 2000, are: mmO<sub>2</sub> covering the group's interests in mobile communications; BT Ignite responsible for broadband and internet networks; BTopenworld covering the consumer market for internet products around the world; and Yell, responsible for the classified directories and associated e-commerce businesses. The two UK operating lines of business, which were formed in autumn 2000, are a wholesale line of business covering the UK fixed-network and a retail line of business responsible for marketing UK fixed-network products.

The turnover of each line of business is derived as follows:

- BT Retail derives its turnover from the supply of exchange lines to the group's UK customers and from the calls they make over these lines, the leasing of private circuits and other private services, and the sale and rental of customer premises equipment.
- BT Wholesale derives its turnover from providing network services to BT Retail and other BT lines of business, and from interconnecting the group's UK network to other operators.
- mmO<sub>2</sub> mainly derives its turnover from the calls made and received by its customers using its mobile phones, from subscription fees charged to its contract customers and from handset equipment sales.
- BT Ignite mainly generates its turnover from outsourcing and systems integration work and from the fixed-network operations of the group's European subsidiaries. The business also derives revenues from providing web hosting facilities.
- BTopenworld mainly derives its turnover from its narrowband internet access products, mainly by selling advertising.
- Yell derives its turnover from selling advertising in its classified directories in the UK and in the US. Details of the sale are set out under "Material Contracts" in Part 9 of this document.

Prior to the restructuring implemented during the year ended 31 March 2001, the group was managed as a unitary business providing an integrated range of services. For the purposes of exercising day-to-day managerial and budgetary control, however, the business was divided internally into divisions but these divisions were not self-standing businesses. Control was exercised by comparing performance against budgets agreed in advance. The group's chief operating decision maker (the CEO) reviewed the turnover and operating results for each main division. The group's capital expenditure programmes were largely centrally driven and were not necessarily linked to individual divisions. For this reason it had been group policy not to allocate certain assets to individual divisions, although depreciation charges were allocated.

Segmented information on the new lines of business is given below for the year ended 31 March 2001 as required by the UK accounting standard SSAP 25 and the US accounting standard SFAS No. 131 (SFAS 131).

Financial information in the group's new form was made available to the senior management of the group with respect to accounting periods from 1 July 2000.

For the years ended 31 March 1999 and 2000, information is provided as required by the US accounting standard, SFAS 131, on disclosures about segments of an enterprise. The information presented is required to be based on the segmental operating results regularly reviewed by the CEO.



Because of the fundamental restructuring and the previous progressive reorganisation explained below, it has not been practicable to restate the segment information for the years ended 31 March 1999 and 2000 onto the segment basis presented for the year ended 31 March 2001 with the limited exceptions of mmO<sub>2</sub> and Yell.

Between September 1997 and July 2000, the group was organised into two main divisions, BT UK and BT Worldwide, in order to reflect the group's two distinctive geographical operating regions and customer groups. Substantially all of the group's operations were within the UK and, of those, the majority were managed by BT UK. During the year ended 31 March 2000 and progressively from 1 October 1998, BT UK was sub-divided into ten separate business units, the principal five of which were Markets, Enterprises, Networks and Systems, Mobility, and Products and Solutions. Markets was the division providing the customer facing links for the group's fixed-network services and Enterprises managed the Yellow Pages classified directory business and the group's wholesale interconnect business with other operators. Networks and Systems provided the UK fixed-network as a platform for these services. Mobility provided the group's UK mobile communication services, principally via BT Cellnet. Products and Solutions managed the group's outsourcing services.

Prior to 30 September 1998, the Consumer Division within BT UK provided fixed-network telecommunication services for residential customers, principally the provision of exchange lines to customers' homes and calls to and from those homes. The Business Division provided fixed-network services to businesses and organisations other than multinational companies, principally the provision of exchange lines, private services and calls to and from their places of business and customer premises equipment. The Networks and Systems Division built, maintained and operated the company's fixed telecommunications network in the UK. Mobile Communications provided the group's UK mobile communications services. Other units within BT UK provided the group's classified advertising directories and outsourcing services.

BT Worldwide provided telecommunication service to multinational companies, including those based in the UK, and international incoming, outgoing and transit telecommunication services. It was responsible for managing Concert Communications and the group's other non-UK operations, and investments in non-UK joint ventures and associates.

## Part 5: Financial information on BT and BT Group

The following information for the year ended 31 March 1999 set out below is based on the divisional organisation of the group at 1 April 1998, described above. As already noted, the BT UK organisation was changed progressively from 1 October 1998 into a substantially different form. Financial information in its then new form and set out for the year ended 31 March 2000 was made available to the senior management of the group with respect to accounting periods from 1 April 1999.

Year ended 31 March 2001	Turnover			Depreciation and amortisation £m	Operating profit (loss) of associates and joint ventures £m	Total operating profit (loss) £m
	External £m	Internal £m	Business total £m			
BT Retail	10,657	1,154	11,811	185	—	1,003
BT Wholesale	3,005	8,488	11,493	1,738	—	2,540
BT Ignite	2,968	502	3,470	649	(124)	(672)
mmO <sub>2</sub>	2,873	535	3,408	3,416	(264)	(3,374)
Concert	—	—	—	—	(1)	(1)
Yell	768	6	774	35	2	188
BTopenworld	85	82	167	37	(69)	(296)
Other	71	302	373	371	59	276
Eliminations	—	(11,069)	(11,069)	—	—	—
<b>Group totals</b>	<b>20,427</b>	<b>—</b>	<b>20,427</b>	<b>6,431</b>	<b>(397)</b>	<b>(336)</b>
BT Group			17,130	2,952	(532)	2,491
Discontinued activities			4,148	3,479	135	(2,827)
Elimination of trading between BT Group and discontinued activities			(851)	—	—	—
<b>Group totals</b>			<b>20,427</b>	<b>6,431</b>	<b>(397)</b>	<b>(336)</b>

The following table shows the capital expenditure on plant, equipment and property for the year ended 31 March 2001 and the net operating assets of the new lines of business at 31 March 2001. Net operating assets comprise tangible and intangible fixed assets, stocks, debtors, less creditors, excluding loans and other borrowings, and provisions for liabilities and charges, excluding deferred tax.

	Capital expenditure £m	Net operating assets (liabilities) £m	Associates and joint ventures £m
BT Retail	157	1,114	—
BT Wholesale	2,273	12,511	—
mmO <sub>2</sub>	1,105	18,634	27
BT Ignite	936	3,584	178
Concert	—	—	1,430
Yell	21	710	2
BTopenworld	25	(17)	12
Other	469	1,040	2,507
<b>Total</b>	<b>4,986</b>	<b>37,576</b>	<b>4,156</b>

Year ended 31 March 2000	Turnover		Business total £m	Depreciation and amortisation £m	Operating profit (loss) of associates and joint ventures £m	Total operating profit (loss) £m
	External £m	Internal £m				
Markets	11,636	8	11,644	67	(9)	2,564
Enterprises	3,114	328	3,442	100	(4)	835
Networks & Systems	3	—	3	1,812	—	4
Mobility	2,170	391	2,561	305	8	117
Products and Solutions	197	368	565	76	(103)	240
Other	10	2	12	132	—	(175)
Eliminations	—	(1,004)	(1,004)	—	—	—
<b>Total BT UK</b>	<b>17,130</b>	<b>93</b>	<b>17,223</b>	<b>2,492</b>	<b>(108)</b>	<b>3,585</b>
BT Worldwide	1,540	129	1,669	176	(335)	(520)
Other	45	10	55	173	43	133
Eliminations	—	(232)	(232)	—	—	—
<b>Group totals</b>	<b>18,715</b>	<b>—</b>	<b>18,715</b>	<b>2,841</b>	<b>(400)</b>	<b>3,198</b>
BT Group			16,125	2,467	(213)	3,169
Discontinued activities			3,269	374	(187)	29
Elimination of trading between BT Group and discontinued activities			(679)	—	—	—
<b>Group totals</b>			<b>18,715</b>	<b>2,841</b>	<b>(400)</b>	<b>3,198</b>

The above includes the following information presented on the new lines of business structure:

mmO <sub>2</sub>	2,245	391	2,636	313	(243)	(170)
Yell	617	5	622	18	1	191

## Part 5: Financial information on BT and BT Group

Business total	Total operating profit (loss)	Turnover		Depreciation and amortisation	Operating profit (loss) of associates and joint ventures	
		External	Internal			
Year ended 31 March 1999	£m	£m	£m	£m	£m	£m
Business Division	5,624	294	5,918	106	—	1,535
Consumer Division	6,168	140	6,308	113	(7)	1,998
Networks & Systems	108	—	108	1,716	(3)	96
Mobile Communications	1,400	312	1,712	195	6	189
Other	1,282	1,877	3,159	126	(38)	(93)
Eliminations	—	(2,351)	(2,351)	—	—	—
<b>Total BT UK</b>	<b>14,582</b>	<b>272</b>	<b>14,854</b>	<b>2,256</b>	<b>(42)</b>	<b>3,725</b>
BT Worldwide	2,361	984	3,345	145	(292)	(327)
Other	10	847	857	180	(8)	76
Eliminations	—	(2,103)	(2,103)	—	—	—
<b>Group totals</b>	<b>16,953</b>	<b>—</b>	<b>16,953</b>	<b>2,581</b>	<b>(342)</b>	<b>3,474</b>
BT Group			15,197	2,375	(214)	3,241
Discontinued activities			2,304	206	(128)	233
Elimination of trading between BT Group and discontinued activities			(548)	—	—	—
<b>Group totals</b>			<b>16,953</b>	<b>2,581</b>	<b>(342)</b>	<b>3,474</b>

The above includes the following information presented on the new lines of business structure:

mmO <sub>2</sub>	1,510	312	1,822	195	(152)	45
Yell	466	3	469	6	—	177

Transactions between divisions are at prices set in accordance with those agreed with Ofcom where the services provided are subject to regulation. Other transactions are at arms length. Internal supplies of services from Networks & Systems were accounted for by that division as negative costs in 1999 and 2000.

Information about geographic areas:

	2001 £m	2000 £m	1999 £m
<b>Turnover with external customers</b>			
Attributable to UK	<b>18,642</b>	17,161	15,612
Attributable to non-UK countries <sup>(a)</sup>	<b>1,785</b>	1,554	1,341
<b>Group turnover</b>	<b>20,427</b>	<b>18,715</b>	<b>16,953</b>

Note:

- (a) Turnover attributable to non-UK countries comprises the external turnover of group companies and branches operating outside the UK, income from non-UK operators for calls terminating in or in transit through the UK and turnover with non-UK joint ventures and associates.

	2001 £m	2000 £m	1999 £m
<b>Group fixed assets are located</b>			
UK	26,167	20,940	18,271
Europe, excluding the UK	13,893	3,935	1,304
Americas	2,990	2,549	218
Asia and Pacific	2,159	2,394	635
<b>Total</b>	<b>45,209</b>	<b>29,818</b>	<b>20,428</b>

Geographical segment analysis in accordance with the requirements of SSAP 25 is as follows:

	2001 £m	2000 £m	1999 £m
<b>Total turnover on basis of origin</b>			
UK	18,500	17,975	16,485
Europe, excluding the UK	3,084	1,891	1,231
Americas	2,771	979	237
Asia and Pacific	5,311	1,058	270
<b>Total</b>	<b>29,666</b>	<b>21,903</b>	<b>18,223</b>

BT Group	21,063	18,228	16,186
Sales to discontinued activities			
Discontinued activities	9,454	4,354	2,585
Elimination of trading between BT Group and discontinued activities	(851)	(679)	(548)
<b>Total</b>	<b>29,666</b>	<b>21,903</b>	<b>18,223</b>

	2001 £m	2000 £m	1999 £m
<b>Group turnover on basis of origin</b>			
UK	18,642	17,866	16,364
Europe, excluding the UK	1,183	285	240
Americas	368	383	237
Asia and Pacific	234	181	112
<b>Total</b>	<b>20,427</b>	<b>18,715</b>	<b>16,953</b>

The analysis of turnover by geographical area is stated on the basis of origin. In an analysis of turnover by destination, incoming and transit international calls by country of origin and turnover with non-UK joint ventures and associates would be treated differently but would not lead to a materially different geographical analysis. See the "information about geographic areas" above.

## Part 5: Financial information on BT and BT Group

	2001 £m	2000 £m	1999 £m
<b>Group operating profit (loss)</b>			
UK	3,520	3,621	3,858
Europe, excluding the UK	(3,346)	(42)	(31)
Americas	(7)	34	4
Asia and Pacific	(106)	(15)	(15)
<b>Total</b>	<b>61</b>	<b>3,598</b>	<b>3,816</b>
BT Group	3,023	3,382	3,455
Discontinued activities	(2,962)	216	361
<b>Total</b>	<b>61</b>	<b>3,598</b>	<b>3,816</b>

	2001 £m	2000 £m	1999 £m
<b>Share of operating results of associates and joint ventures, including goodwill amortisation — profits (losses)</b>			
UK	(32)	(118)	(13)
Europe, excluding the UK	(471)	(312)	(307)
Americas	(66)	43	—
Asia and Pacific	172	(13)	(22)
<b>Total</b>	<b>(397)</b>	<b>(400)</b>	<b>(342)</b>
BT Group	(532)	(213)	(214)
Discontinued activities	135	(187)	(128)
<b>Total</b>	<b>(397)</b>	<b>(400)</b>	<b>(342)</b>

Year ended 31 March	2001			2000			1999		
	Net operating assets £m	Associates and joint ventures £m	Total £m	Net operating assets £m	Associates and joint ventures £m	Total £m	Net operating assets £m	Associates and joint ventures £m	Total £m
UK	23,750	42	23,792	16,428	17	16,445	14,509	30	14,539
Europe, excluding the UK	12,878	468	13,346	2,232	1,296	3,528	(2)	905	903
Americas	783	1,716	2,499	653	1,724	2,377	129	—	129
Asia and Pacific	165	1,930	2,095	156	2,188	2,344	(9)	565	556
<b>Total</b>	<b>37,576</b>	<b>4,156</b>	<b>41,732</b>	<b>19,469</b>	<b>5,225</b>	<b>24,694</b>	<b>14,627</b>	<b>1,500</b>	<b>16,127</b>

Net operating assets comprise tangible and intangible fixed assets, stocks, debtors less creditors, excluding loans and other borrowings, and provisions for liabilities and charges, excluding deferred tax.

### 3. Turnover

	2001 £m	2000 <sup>(a)</sup> £m	1999 <sup>(a)</sup> £m
Fixed-network calls	5,655	5,908	6,026
Exchange lines	3,674	3,526	3,351
Receipts from other operators	2,814	1,974	1,417
Wireless products	2,760	2,170	1,400
Private services	1,091	1,135	1,140
Solutions	1,074	915	746
Yellow Pages and other directories	754	642	491
Customer premises equipment supply	726	847	870
Other sales and services	1,879	1,598	1,512
<b>Group turnover</b>	<b>20,427</b>	<b>18,715</b>	<b>16,953</b>
Group's share of associates' and joint ventures' turnover	9,937	3,364	1,270
Trading between group and principal joint venture	(698)	(176)	—
<b>Total turnover</b>	<b>29,666</b>	<b>21,903</b>	<b>18,223</b>

*Note:*

(a) Figures in the 1999 and 2000 financial years have been restated to conform with the method of classification used in the 2001 financial year.

Group's share of associates' and joint ventures' turnover comprised:

	2001 £m	2000 £m	1999 £m
Joint ventures	4,018	1,784	561
Associates:			
Continuing activities	3,557	1,580	709
Acquisitions	2,362	—	—
	5,919	1,580	709
<b>Group's share of associates' and joint ventures' turnover</b>	<b>9,937</b>	<b>3,364</b>	<b>1,270</b>
BT Group	4,631	2,279	989
Discontinued activities	5,306	1,085	281
<b>Group's share of associates' and joint ventures' turnover</b>	<b>9,937</b>	<b>3,364</b>	<b>1,270</b>

Approximately 9 per cent. (2000 — 5 per cent., 1999 — 4 per cent.) of group turnover arose from operations outside the UK and approximately 38 per cent. (2000 — 18 per cent., 1999 — 10 per cent.) of total turnover arose from activities outside the UK (note 2).

Concert, the joint venture with AT&T, was formed on 5 January 2000 (see note 16). From that date, international calls into, through and out of the UK and formerly handled by the company, have been handled by Concert. Additionally, certain of the company's multinational customers were transferred to Concert on the same date.

Fixed-network calls comprise calls within the UK and calls made from the UK to other countries. Receipts from other operators include revenues from Concert for terminating incoming international calls from 5 January 2000 and revenues from non-UK operators for incoming and transit calls into and through the UK up to that date.

The group's share of trading with Concert, primarily in respect of international calls made to and from the UK and for services provided to Concert in the UK for the multinational customers transferred to Concert, is eliminated in arriving at total turnover, including the proportionate share of the group's associates and joint ventures, and is added back in arriving at group turnover.

## Part 5: Financial information on BT and BT Group

### 4. Other operating income

	2001 £m	2000 £m	1999 £m
Seconded staff and administration and other services provided to Concert	168	79	—
Other	225	163	168
<b>Total other operating income</b>	<b>393</b>	<b>242</b>	<b>168</b>
BT Group	393	242	168
Discontinued activities	—	—	—
<b>Total other operating income</b>	<b>393</b>	<b>242</b>	<b>168</b>



## 5. Operating costs

	Discontinued			Discontinued			Discontinued		
	BT Group 2001 £m	activities 2001 £m	Total 2001 £m	BT Group 2000 £m	activities 2000 £m	Total 2000 £m	BT Group 1999 £m	activities 1999 £m	Total 1999 £m
<b>Staff costs:</b>									
Wages and salaries	3,468	486	3,954	3,472	282	3,754	3,190	176	3,366
Social security costs	272	41	313	290	26	316	260	15	275
Pension costs (note 30)	294	32	326	151	16	167	163	13	176
Employee share ownership scheme <sup>(a)</sup>	32	—	32	59	—	59	64	—	64
<b>Total staff costs</b>	<b>4,066</b>	<b>559</b>	<b>4,625</b>	<b>3,972</b>	<b>324</b>	<b>4,296</b>	<b>3,677</b>	<b>204</b>	<b>3,881</b>
Own work capitalised	(645)	(48)	(693)	(475)	(23)	(498)	(414)	(14)	(428)
Depreciation (note 19)	2,668	377	3,045	2,457	295	2,752	2,375	206	2,581
Amortisation and impairment of goodwill and other intangibles (note 18)	284	3,102	3,386	10	79	89	—	—	—
Payments to telecommunications operators	3,701	101	3,802	3,010	76	3,086	2,278	(158)	2,120
Other operating costs <sup>(b)</sup>	4,426	2,168	6,594	4,011	1,623	5,634	3,994	1,157	5,151
<b>Total operating costs</b>	<b>14,500</b>	<b>6,259</b>	<b>20,759</b>	<b>12,985</b>	<b>2,374</b>	<b>15,359</b>	<b>11,910</b>	<b>1,395</b>	<b>13,305</b>
Operating costs included the following:									
Redundancy charges	95	9	104	59	—	59	124	—	124
Research and development	361	3	364	338	7	345	265	3	268
Rental costs relating to operating leases, including plant and equipment hire £15 million (2000 — £12 million, 1999 — £9 million)	156	10	166	155	34	189	178	7	185
Foreign currency gains	(50)	—	(50)	(26)	—	(26)	(88)	—	(88)
Amortisation of goodwill and exceptional items comprising:									
Exceptional costs relating to impairment of goodwill	200	2,800	3,000	—	—	—	—	—	—
Exceptional credit for rates refunds, relating to prior years	(193)	—	(193)	—	—	—	—	—	—
Exceptional costs relating to the write off of subscriber acquisition costs <sup>(c)</sup>	—	7	7	—	—	—	—	—	—
Exceptional costs relating to the write off of Viag Interkom IT systems	22	21	43	—	—	—	—	—	—
Exceptional costs relating to the proposed closure of the BT Cellnet analogue network:									
Depreciation	—	—	—	—	37	37	—	—	—
Other operating costs	—	—	—	—	10	10	—	—	—
	—	—	—	—	47	47	—	—	—
Exceptional costs relating to the disengagement from MCI:									
Staff costs	—	—	—	13	—	13	10	—	10
Depreciation	—	—	—	11	—	11	13	—	13
Payments to telecommunication operators	—	—	—	18	—	18	14	—	14
Other operating costs	—	—	—	22	—	22	32	—	32
	—	—	—	64	—	64	69	—	69
<b>Total exceptional items</b>	<b>29</b>	<b>2,828</b>	<b>2,857</b>	<b>64</b>	<b>47</b>	<b>111</b>	<b>69</b>	<b>—</b>	<b>69</b>
Goodwill amortisation	81	292	373	10	79	89	—	—	—
<b>Total amortisation of goodwill and exceptional items</b>	<b>110</b>	<b>3,120</b>	<b>3,230</b>	<b>74</b>	<b>126</b>	<b>200</b>	<b>69</b>	<b>—</b>	<b>69</b>

### Notes:

- (a) Amount set aside for the year for allocation of ordinary shares in the company to eligible employees.
- (b) No charge for the cost of providing incremental pension benefits for employees taking early retirement was made in the years ended 31 March 2001, 2000 and 1999 in view of the combined surplus in the BT Pension Scheme disclosed by the actuarial valuations as at 31 December 1999 and 1996, and the amount provided for pension costs within provisions for liabilities and charges.
- (c) The accounting of all the mmO<sub>2</sub> operating units has been aligned; this has resulted in a write off of previously capitalised costs in certain non-UK operations.

## Part 5: Financial information on BT and BT Group

The directors believe that the nature of the group's business is such that the analysis of operating costs required by the Companies Act 1985 is not appropriate. As required by the Act, the directors have therefore adapted the prescribed format so that operating costs are disclosed in a manner appropriate to the group's principal activity.

The operating costs for the year ended 31 March 2001 set out above, include the following amounts relating to acquisitions made in the year.

	2001 £m
Total staff costs	65
Depreciation	76
Amortisation of intangibles	8
Payments to telecommunications operators	138
Other operating costs	246
<b>Total operating costs</b>	<b>533</b>

### 6. Group's share of operating profit (loss) of associates and joint ventures

The group's share of operating profit (loss) of associates and joint ventures comprised:

	Discontinued			Discontinued			Discontinued		
	BT Group	activities	Total	BT Group	activities	Total	BT Group	activities	Total
	2001	2001	2001	2000 <sup>(b)</sup>	2000 <sup>(b)</sup>	2000 <sup>(b)</sup>	1999 <sup>(b)</sup>	1999 <sup>(b)</sup>	1999 <sup>(b)</sup>
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Joint ventures:									
Continuing	(427)	50	(377)	(147)	23	(124)	(89)	5	(84)
Acquisitions	(8)	—	(8)	—	—	—	—	—	—
Discontinued or subsequently wholly acquired	(73)	(308)	(381)	(64)	(239)	(303)	(119)	(139)	(258)
	(508)	(258)	(766)	(211)	(216)	(427)	(208)	(134)	(342)
Associates:									
Continuing	(23)	191	168	33	8	41	(6)	6	—
Acquisitions	(1)	202	201	(35)	21	(14)	—	—	—
	(24)	393	369	(2)	29	27	(6)	6	—
<b>Group's share of operating loss of associates and joint ventures<sup>(a)</sup></b>	<b>(532)</b>	<b>135</b>	<b>(397)</b>	<b>(213)</b>	<b>(187)</b>	<b>(400)</b>	<b>(214)</b>	<b>(128)</b>	<b>(342)</b>

#### Notes:

##### (a) Includes:

Exceptional item relating to impairment of goodwill	200	—	200	—	—	—	—	—	—
Exceptional item relating to write off of subscriber acquisition costs	96	36	132	—	—	—	—	—	—
Amortisation of goodwill arising in joint ventures and associates	78	107	185	57	27	84	10	7	17

(b) Prior years' figures have been restated to provide comparative information for joint ventures discontinued or subsequently wholly acquired in the year ended 31 March 2001.

## 7. Profit on sale of fixed asset investments and group undertakings

In November 2000, the group sold its 34 per cent. stake in sunrise communications, its joint venture in Switzerland, to a fellow shareholder for a consideration of £464 million, on which a realised profit of £454 million has been recognised. In December 2000, BT sold off part of its Aeronautical and Maritime division at a profit of £46 million. Reductions in BT's holdings in I.Net SpA and British Interactive Broadcasting Limited resulted in gains of £38 million and £25 million, respectively. Other gains during the year totalled £56 million. All these items have been classified as exceptional in the year ended 31 March 2001.

In August 1999, the group sold BT Communications Services KK to Japan Telecom for a consideration of £170 million, on which a realised profit of £80 million has been recognised. In February 2000, BT's photonics research facility was sold at a profit of £35 million. Other gains during the year totalled £11 million. All these items have been classified as exceptional in the year ended 31 March 2000.

In September 1998, the group completed the sale of its interest in MCI for £4,159 million at a pre-tax profit of £1,133 million, after taking into account goodwill of £2,214 million originally written off on the acquisition of the group's interest in MCI in September 1994. A provision for impairment of £26 million against another fixed asset investment has been offset against this profit giving a net gain of £1,107 million. These two items have been classified as exceptional in the year ended 31 March 1999.

With the exception of Concert Communications (see note 16), the subsidiary undertakings disposed of in the years ended 31 March 2001, 2000 and 1999 had a negligible effect on the group's operating profit and cash flows and their net assets were immaterial to the group's financial position.

## 8. Interest receivable

	Discontinued			Discontinued			Discontinued		
	BT Group 2001 £m	activities 2001 £m	Total 2001 £m	BT Group 2000 £m	activities 2000 £m	Total 2000 £m	BT Group 1999 £m	activities 1999 £m	Total 1999 £m
Income from listed investments	26	4	30	10	3	13	7	2	9
Other interest receivable <sup>(a)</sup>	447	(95)	352	193	(24)	169	167	(17)	150
Group	473	(91)	382	203	(21)	182	174	(15)	159
Joint ventures	17	2	19	2	2	4	2	—	2
Associates	4	3	7	6	1	7	4	—	4
<b>Total interest receivable</b>	<b>494</b>	<b>(86)</b>	<b>408</b>	<b>211</b>	<b>(18)</b>	<b>193</b>	<b>180</b>	<b>(15)</b>	<b>165</b>

*Note:*  
(a) Includes:  
Exceptional credit for interest on rates refunds received in 2000, relating to prior years

	25	—	25	—	—	—	—	—	—
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## 9. Interest payable

	Discontinued			Discontinued			Discontinued		
	BT Group 2001 £m	activities 2001 £m	Total 2001 £m	BT Group 2000 £m	activities 2000 £m	Total 2000 £m	BT Group 1999 £m	activities 1999 £m	Total 1999 £m
Interest payable and similar charges in respect of:									
Bank loans and overdrafts	179	2	181	86	1	87	77	—	77
Other borrowings <sup>(a)</sup>	1,207	38	1,245	381	20	401	339	4	343
Group	1,386	40	1,426	467	21	488	416	4	420
Joint ventures	28	148	176	39	8	47	18	1	19
Associates	114	6	120	36	4	40	7	5	12
<b>Total interest payable</b>	<b>1,528</b>	<b>194</b>	<b>1,722</b>	<b>542</b>	<b>33</b>	<b>575</b>	<b>441</b>	<b>10</b>	<b>451</b>

*Note:*

(a) Includes £7 million premium charged in the year ended 31 March 1999 on the early redemption of US\$200 million 9½% Guaranteed Debentures 2019 on 16 February 1999.

## Part 5: Financial information on BT and BT Group

### 10. Tax on profit (loss) on ordinary activities

	2001 £m	2000 £m	1999 £m
United Kingdom:			
Corporation tax at 30% (2000 — 30%, 1999 — 31%)	690	852	1,200
Deferred taxation charge (credit) at 30%	27	(3)	71
Taxation on the group's share of results of associates	6	3	1
Taxation on the group's share of results of joint ventures	42	—	—
Prior year adjustments	(296)	4	—
<b>Total UK taxation</b>	<b>469</b>	<b>856</b>	<b>1,272</b>
Non-UK taxation:			
Current	24	5	14
Taxation charge on the group's share of results of joint ventures	33	11	3
Taxation charge on the group's share of results of associates	146	25	4
Prior year adjustments	(20)	—	—
<b>Total tax on profit (loss) on ordinary activities</b>	<b>652</b>	<b>897</b>	<b>1,293</b>
BT Group	508	827	1,197
Discontinued activities	144	70	96
<b>Total tax on profit (loss) on ordinary activities</b>	<b>652</b>	<b>897</b>	<b>1,293</b>

In the year ended 31 March 2001, the loss on ordinary activities before taxation was £1,031 million, after charging £3,200 million goodwill impairment, which is not an allowable expense for taxation. In the following table, the effective corporation tax rate is reconciled to the profit of £2,169 million before this impairment charge.

Total tax on profit on ordinary activities, varied from the amount computed by applying the corporation tax rate to profit on ordinary activities before taxation. The differences were attributable to the following factors:

	2001 %	2000 %	1999 %
UK corporation tax rate	30.0	30.0	31.0
Non-deductible depreciation and amortisation	9.0	2.5	0.6
Non-deductible non-UK losses	11.3	2.7	1.5
Higher taxes on non-UK profits	4.0	—	—
Unprovided deferred taxes on excess capital allowances	(2.8)	(2.0)	(0.7)
Lower effective tax on net foreign exchange gains	—	(1.2)	—
Effect of reduction in UK corporation tax rate on deferred tax provision	—	—	(0.1)
Lower effective tax on gain in MCI shares	—	—	(2.4)
Lower effective tax on gain on disposal of fixed asset investments and group undertakings	(8.3)	(1.2)	—
Prior year adjustments	(14.6)	—	—
Other	1.5	(0.3)	0.2
<b>Effective corporation tax rate</b>	<b>30.1</b>	<b>30.5</b>	<b>30.1</b>

Deferred taxation of £60 million (2000 — £60 million, 1999 — £30 million) arising on excess capital allowances was not provided in the year ended 31 March 2001.

The deferred taxation charge (credit) was mainly the result of the tax effect of timing differences as follows:

	2001 £m	2000 £m	1999 £m
Excess capital allowances	(74)	(80)	1
Pension provisions	87	97	81
Other timing differences	14	(20)	(11)
	27	(3)	71
Prior year adjustments <sup>(a)</sup>	(111)	16	5
<b>Total deferred taxation charge (credit)</b>	<b>(84)</b>	<b>13</b>	<b>76</b>

Note:

(a) Reclassification between deferred and current taxation on the profit on ordinary activities for prior years.

### 11. Minority interests

	Discontinued activities			Discontinued activities			Discontinued activities		
	BT Group 2001 £m	2001 £m	Total 2001 £m	BT Group 2000 £m	2000 £m	Total 2000 £m	BT Group 1999 £m	1999 £m	Total 1999 £m
Minority interests in profits (losses):									
Group	2	4	6	(16)	1	(15)	(17)	32	15
Associates	(4)	125	121	7	(2)	5	4	—	4
<b>Total minority interests</b>	<b>(2)</b>	<b>129</b>	<b>127</b>	<b>(9)</b>	<b>(1)</b>	<b>(10)</b>	<b>(13)</b>	<b>32</b>	<b>19</b>

### 12. Dividends

	2001 pence per share	2000 pence per share	1999 pence per share	2001 £m	2000 £m	1999 £m
Interim dividend paid	7.80	7.80	7.26	571	565	523
Proposed final dividend	—	11.84	11.03	—	861	799
<b>Total dividends</b>	<b>7.80</b>	<b>19.64</b>	<b>18.29</b>	<b>571</b>	<b>1,426</b>	<b>1,322</b>

The dividends per share have been restated for the dilutionary effect of the rights issue which closed on 15 June 2001.

### 13. Earnings (loss) per share

The basic earnings (loss) per share are calculated by dividing the profit for the financial year attributable to shareholders by the weighted average number of shares in issue after deducting the company's shares held by employee share ownership trusts. The number of shares used in the calculations have been restated for the rights issue which closed on 15 June 2001.

In calculating the diluted earnings (loss) per share, share options outstanding and other potential ordinary shares have been taken into account.

The weighted average number of shares in the years were:

	2001 millions of shares	2000 millions of shares	1999 millions of shares
Basic	7,276	7,235	7,183
Dilutive ordinary shares from share options outstanding and shares held in trust	107	171	167
<b>Total diluted</b>	<b>7,383</b>	<b>7,406</b>	<b>7,350</b>

Options over 39 million shares were excluded from the calculation of the total diluted number of shares in the year ended 31 March 2001 because to do so would have been antidilutive.

## Part 5: Financial information on BT and BT Group

The items in the calculation of earnings (loss) per share before goodwill amortisation and exceptional items in the years were:

	2001 pence per share	2000 pence per share	1999 pence per share	2001 £m	2000 £m	1999 £m
Profit on sale of group undertakings	8.4	1.7	—	619	126	—
Rates refunds relating to prior years	2.7	—	—	193	—	—
Goodwill impairment	(44.0)	—	—	(3,200)	—	—
Write off of subscriber acquisition costs	(1.9)	—	—	(139)	—	—
Viag Interkom write off of IT Systems	(0.6)	—	—	(43)	—	—
Interest receivable on rates refunds, relating to prior years	0.3	—	—	25	—	—
Costs relating to the closure of the BT Cellnet analogue network	—	(0.6)	—	—	(47)	—
Profit on sale of MCI shares	—	—	15.8	—	—	1,133
Provision against another fixed asset investment	—	—	(0.4)	—	—	(26)
Costs relating to the disengagement from MCI	—	(0.9)	(1.0)	—	(64)	(69)
Goodwill amortisation	(7.6)	(2.4)	(0.3)	(558)	(173)	(17)
<b>Total credit (charge) before tax and minority interest</b>	<b>(42.7)</b>	<b>(2.2)</b>	<b>14.1</b>	<b>(3,103)</b>	<b>(158)</b>	<b>1,021</b>
Tax charge attributable	(0.3)	(0.1)	(4.0)	(22)	(5)	(291)
Minority Interest	(0.3)	—	—	(21)	—	—
<b>Net credit (charge)</b>	<b>(43.3)</b>	<b>(2.3)</b>	<b>10.1</b>	<b>(3,146)</b>	<b>(163)</b>	<b>730</b>
Basic earnings (loss) per share/profit for the financial year after goodwill amortisation and exceptional items	(24.9)	28.4	41.5	(1,810)	2,055	2,983
Goodwill amortisation and exceptional charge (credit)	43.3	2.3	(10.1)	3,146	163	(730)
<b>Basic earnings per share/profit for the financial year before goodwill amortisation and exceptional items</b>	<b>18.4</b>	<b>30.7</b>	<b>31.4</b>	<b>1,336</b>	<b>2,218</b>	<b>2,253</b>

Earnings per share before goodwill amortisation and exceptional items are provided to help readers evaluate the performance of the group.

### 14. Reconciliation of operating profit to operating cash flows

	2001 £m	2000 £m	1999 £m
Group operating profit	61	3,598	3,816
Depreciation	3,045	2,752	2,581
Goodwill amortisation and impairment	3,386	89	—
Increase in stocks	(67)	(48)	(8)
Increase in debtors	(432)	(1,175)	(410)
Increase in creditors	203	982	388
Decrease in provisions	(222)	(295)	(259)
Other	(87)	(54)	(73)
<b>Net cash inflow from operating activities</b>	<b>5,887</b>	<b>5,849</b>	<b>6,035</b>

### 15. Management of liquid resources

	2001 £m	2000 £m	1999 £m
Purchase of short-term investments and payments into short-term deposits over three months	(1,344)	(3,178)	(2,973)
Sale of short-term investments and withdrawals from short-term deposits over three months	1,765	3,850	1,735
Net movement of short-term investments and short-term deposits under three months not repayable on demand	(901)	564	(1,209)
<b>Net cash inflow (outflow) from management of liquid resources</b>	<b>(480)</b>	<b>1,236</b>	<b>(2,447)</b>

Movements in all short-term investments and deposits not repayable on demand are reported under the heading of management of liquid resources.

## 16. Acquisitions and disposals

### Acquisition of subsidiary companies

Year ended 31 March 2001	Viag Interkom <sup>(a)</sup> £m	Telfort <sup>(c)</sup> £m	Other £m	Total £m
Consideration:				
Cash	8,770	1,207	160	10,137
Carrying value of joint venture wholly acquired	479	235	—	714
<b>Total</b>	<b>9,249</b>	<b>1,442</b>	<b>160</b>	<b>10,851</b>

  

Year ended 31 March 2000	Cellnet Group <sup>(e)</sup> £m	Esat <sup>(f)</sup> £m	Yellow Book (USA) <sup>(g)</sup> £m	Syntegra (USA) <sup>(h)</sup> £m	Other £m	Total £m
Consideration:						
Cash	3,014	179	401	213	327	4,134
Deferred	—	1,167	—	—	45	1,212
Loan notes 2000/2009	159	—	—	—	—	159
Other loan notes	—	174	14	—	14	202
Carrying value of associate wholly acquired	—	—	—	—	23	23
<b>Total</b>	<b>3,173</b>	<b>1,520</b>	<b>415</b>	<b>213</b>	<b>409</b>	<b>5,730</b>

  

Year ended 31 March 1999	Concert <sup>(i)</sup> £m	MDT <sup>(j)</sup> £m	Other £m	Total £m
Consideration:				
Cash	607	41	19	667
Deferred	—	—	8	8
Loan notes 1999/2006	—	90	—	90
<b>Total</b>	<b>607</b>	<b>131</b>	<b>27</b>	<b>765</b>

- (a) On 20 February 2001, the group took full control of Viag Interkom GmbH & Co (Viag Interkom). Under an agreement announced in August 2000, the group purchased from E.ON its 45 per cent. interest in Viag Interkom by means of a put option priced at €7.25 billion (£4,562 million). In January 2001, the group acquired the 10 per cent. interest in the company previously owned by Telenor for €1.6 billion (£1,032 million). As part of the transactions, the group repaid loans due by Viag Interkom to E.ON and Telenor totalling £3,165 million. The total cash consideration amounted to £8,770 million, including £11 million expenses.

	Book and fair values £m
Fixed assets	6,728
Current assets	619
Current liabilities	(585)
Long-term liabilities	(2,505)
Group's share of original book value of net assets	4,257
Goodwill	4,992
<b>Total cost</b>	<b>9,249</b>
Consideration:	
Cash	8,770
Carrying value of joint venture wholly acquired	479
<b>Total</b>	<b>9,249</b>

Since the acquisition was made towards the end of the year ended 31 March 2001, the fair values of the identifiable assets and liabilities have been determined on a provisional basis. Goodwill arising on acquisition of Viag Interkom is being amortised over 20 years.

## Part 5: Financial information on BT and BT Group

The consolidated results of Viag Interkom for the year ended 31 December 2000 and for the period from 1 January 2001 to 19 February 2001, on the basis of its accounting policies, are summarised as follows:

	Period 1 January to 19 February 2001 £m	Year ended 31 December 2000 £m
Group turnover	216	856
Total operating loss	(108)	(686)
Loss before taxation	(160)	(784)
Taxation	—	—
Minority interests	—	—
Loss for the financial period	(160)	(784)

### (b) Other subsidiary companies

During the year ended 31 March 2001, the acquisition of interests in other subsidiary companies and the consideration given comprised:

Year ended 31 March 2001	Telfort <sup>(c)</sup> £m	Other £m	Total £m
Minority Interest	—	31	31
Fixed assets	496	—	496
Current assets	221	16	237
Current liabilities	(261)	—	(261)
Group share of original book value of net assets (liabilities) and fair value to group	456	47	503
Goodwill	986	113	1,099
<b>Total cost</b>	<b>1,442</b>	<b>160</b>	<b>1,602</b>
Consideration:			
Cash	1,207	160	1,367
Carrying value of joint venture wholly acquired	235	—	235
<b>Total</b>	<b>1,442</b>	<b>160</b>	<b>1,602</b>

- (c) On 22 June 2000, BT received regulatory approval to acquire the remaining 50 per cent. interest of Telfort BV, its provider of fixed and mobile services to businesses and consumers in The Netherlands, that it did not already own for £1,207 million. Goodwill arising on the acquisition of Telfort BV is being amortised over 20 years. Telfort BV's loss after tax for the year ended 31 December 1999 was £141 million and its loss for the six months ended 30 June 2000 was £86 million.



- (d) During the year ended 31 March 2000, the acquisition of the interests in subsidiary companies and the consideration given comprised:

	Cellnet Group <sup>(e)</sup> £m	Esat <sup>(f)</sup> £m	Yellow Book USA <sup>(g)</sup> £m	Syntegra (USA) <sup>(h)</sup> £m	Other £m	Total £m
Minority interest	176	(2)	—	1	40	215
Fixed assets		428	6	12	157	603
Current assets		137	49	48	68	302
Current liabilities		(137)	(21)	(88)	(108)	(354)
Long-term liabilities		(487)	—	—	(62)	(549)
Provisions for liabilities and charges		—	—	—	(2)	(2)
Group share of original book value of net assets (liabilities)	176	(61)	34	(27)	93	215
Fair value adjustment to achieve consistency of accounting policies	—	(115)	—	—	—	(115)
Other fair value adjustments	—	(69)	—	—	—	(69)
Fair value to the group	176	(245)	34	(27)	93	31
Goodwill	2,997	1,765	381	240	316	5,699
<b>Total cost</b>	<b>3,173</b>	<b>1,520</b>	<b>415</b>	<b>213</b>	<b>409</b>	<b>5,730</b>
Consideration:						
Cash	3,014	179	401	213	327	4,134
Deferred	—	1,167	—	—	45	1,212
Loan notes 2000/2009	159	—	—	—	—	159
Other loan notes	—	174	14	—	14	202
Carrying value of associate wholly acquired	—	—	—	—	23	23
<b>Total</b>	<b>3,173</b>	<b>1,520</b>	<b>415</b>	<b>213</b>	<b>409</b>	<b>5,730</b>

- (e) On 10 November 1999, BT acquired the 40 per cent. interest in Cellnet Group Limited, its mobile cellular phone operator, that it did not already own for £3,150 million, excluding £23 million expenses. Goodwill arising on acquisition of Cellnet Group Limited is being amortised over 20 years.

The consolidated results of Cellnet Group Limited for the years ended 31 March 1999 and 2000 are summarised as follows:

	2000 £m	1999 £m
Group turnover	2,435	1,410
Total operating profit	97	165
Exceptional items included in total operating profit:		
Impairment of analogue equipment and network closure costs (note 5)	(47)	—
Profit before taxation	49	117
Taxation	(23)	(39)
Minority interests	(2)	—
Profit for the financial year	24	78

- (f) At the end of March 2000, BT acquired control of Esat Telecom Group plc (Esat), a leading telecommunications operator in Ireland. An interest comprising 70 per cent. of the company was acquired under a public offer, the consideration for which passed in April 2000. In January 2000, BT acquired 13 per cent. of the company from its then chairman and chief executive for US\$287 million (£174 million) and a further 12 per cent. interest from a major shareholder for US\$271 million (£179 million). Of the total consideration, £179 million was settled in cash in January 2000, £1,029 million in cash in April 2000 and £187 million was satisfied by loan notes repayable at the option of the holder not later than 30 April 2005. The balance of the consideration covered the remaining interest which was compulsorily acquired and compensation to employee share option holders. Goodwill arising on acquisition of Esat is being amortised over 20 years.

Esat holds a 49.5 per cent. interest in Esat Digifone. In January 2000, BT acquired a further 1 per cent. interest in this company for £15 million. At 31 March 2000 and 2001, Telenor owned the remaining 49.5 per cent. interest. In the table above, the assets acquired and the liabilities assumed comprise those of both Esat and Esat Digifone. Since BT acquired control just

## Part 5: Financial information on BT and BT Group

before the 2000 financial year end, only a preliminary assessment of the fair values of Esat's assets and liabilities, which were based on 31 December 1999 balance sheets, had been undertaken. The fair value adjustment relates to an uplift of £69 million to the carrying value of Esat's debt to its market value on 30 March 2000. During the year ended 31 March 2001, in the final assessment of fair values, the fair values of the net liabilities were increased by £75 million, the fair value of the consideration was increased by £38 million and goodwill increased by £113 million to £1,878 million.

Esat incurred a loss after tax of IR£120 million (£95 million) for the year ended 31 December 1999.

Under an agreement with Telenor made in 2000, Telenor had the right to exchange its 49.5 per cent. interest in Esat Digifone for a 33 per cent. interest in Esat and a right to purchase from BT such additional shares as would result in Telenor having an almost 50 per cent. interest in Esat at a total price of US\$624 million plus interest. If Telenor did not exercise this right, Telenor agreed to sell its interest in Esat Digifone to the group for US\$1,238 million. In February 2001, Telenor decided to sell its interest in Esat Digifone to the group and this transaction was completed in April 2001 for £856 million.

- (g) On 31 August 1999, BT acquired Yellow Book USA, an independent classified directory publisher in the USA, for £415 million. Yellow Book's loss after tax for the year ended 31 October 1998 was £5 million. Details of the sale are set out under "Material Contracts" in Part 9 of this document.
- (h) On 31 August 1999, BT acquired Syntegra (USA) (previously named Control Data Systems), an international systems integration company based in the USA, for £213 million. Goodwill arising on acquisition of Syntegra (USA) is being amortised over 20 years. Syntegra (USA)'s loss after tax for the year ended 31 December 1998 was £37 million.
- (i) During the year ended 31 March 1999, the acquisition of the interests in Concert Communications on 15 September 1998, Martin Dawes Telecommunications (MDT) (renamed Lumina Limited) on 8 March 1999 and other subsidiary companies and the consideration given comprised:

	Concert £m	MDT £m	Other £m	Total £m
Minority interest	39	—	14	53
Fixed assets		34	1	35
Current assets		101	1	102
Current liabilities		(152)	(3)	(155)
Long-term liabilities		(3)	—	(3)
Group share of original book value of net assets (liabilities)	39	(20)	13	32
Fair value adjustment to achieve consistency of accounting policies	—	(9)	—	(9)
Fair value to the group	39	(29)	13	23
Goodwill	568	160	14	742
<b>Total cost</b>	<b>607</b>	<b>131</b>	<b>27</b>	<b>765</b>
Consideration:				
Cash	607	41	19	667
Deferred	—	—	8	8
Loan notes 1999/2006	—	90	—	90
<b>Total</b>	<b>607</b>	<b>131</b>	<b>27</b>	<b>765</b>

In September 1998, the group acquired MCI's 24.9 per cent. interest in Concert Communications Company (Concert Communications) for £607 million. Goodwill of £568 million arose on this transaction (refer below). This goodwill was transferred into the Concert global venture with AT&T on 5 January 2000.

MDT's profit after tax for the year to 31 December 1998 was £2 million. Goodwill arising on acquisition of MDT is being written off over 10 years.

### Formation of principal joint venture

On 5 January 2000, the company and AT&T formed their global venture named Concert for the two companies' trans-border communications activities. The venture is jointly owned and controlled. The group contributed the majority of its cross-border international networks, its international traffic, its business with selected multinational customers and its international

products for business customers, as well as Concert Communications. AT&T contributed a similar set of assets and businesses.

The book value of the assets contributed by the group to the joint venture comprised:

	£m
Intangible assets	568
Tangible fixed assets	870
Total fixed assets	1,438
Current assets	123
Current liabilities	(183)
Net current assets (liabilities)	(60)
Provisions for liabilities and charges	(13)
Long-term debt owed to the BT Group	(1,169)
<b>Net assets contributed</b>	<b>196</b>

The acquisition of the group's 50 per cent. interest in Concert comprised:

	£m
Group's share of Concert's opening net assets (US GAAP)	631
Group's share of US to UK GAAP adjustments	(180)
Group's share of Concert's opening net assets (UK GAAP)	451
Net assets contributed by the group to the joint venture	(196)
Transition costs	(96)
<b>Unrealised gain on the contribution</b>	<b>159</b>

The gain on the transfer of the assets is unrealised since the group continues to maintain a 50 per cent. interest in the assets contributed. This gain has been taken to a non-distributable reserve and is shown in the statement of total recognised gains and losses for the year ended 31 March 2000. There is no tax charge on the gain.

During the year ended 31 March 2001, the group's share of Concert's opening net assets was amended, due to certain true up contributions, reducing the unrealised gain by £49 million. This is shown in the statement of total recognised gains and losses for the year ended 31 March 2001.

#### Acquisition of associates and joint ventures

	Telenordia <sup>(l)</sup> £m	J-Phone <sup>(k)</sup> £m
Year ended 31 March 2001		
Group share of original book value of net assets (net liabilities)	10	5
Fair value adjustment to achieve consistency of accounting policies	—	—
Fair value to the group	10	5
Goodwill	84	—
<b>Total cost</b>	<b>94</b>	<b>5</b>

	Japan Telecom <sup>(l)</sup> £m	AT&T Canada <sup>(m)</sup> £m	Rogers Cantel Mobile Communi- cations <sup>(m)</sup> £m	Smartone Mobile Communi- cations <sup>(m)</sup> £m	Other <sup>(m)</sup> £m
Year ended 31 March 2000					
Group share of original book value of net assets	871	101	11	96	34
Fair value adjustment to achieve consistency of accounting policies	(49)	—	—	—	—
Fair value to the group	822	101	11	96	34
Goodwill	432	259	288	145	51
<b>Total cost</b>	<b>1,254</b>	<b>360</b>	<b>299</b>	<b>241</b>	<b>85</b>

## Part 5: Financial information on BT and BT Group

Year ended 31 March 1999	Maxis Communi- cations <sup>(n)</sup> £m	LG Telecom <sup>(n)</sup> £m	Airtel Movil <sup>(o)</sup> £m
Group share of original book value of net assets	60	98	62
Fair value adjustment to achieve consistency of accounting policies	(9)	(58)	(19)
Fair value to the group	51	40	43
Goodwill	228	194	158
<b>Total cost</b>	<b>279</b>	<b>234</b>	<b>201</b>

### (j) Telenordia

On 8 September 2000, BT increased its existing 33 per cent. interest in Telenordia, based in Sweden, to 50 per cent. for £94 million. Goodwill is being amortised over 20 years.

### (k) J-Phone

On 8 May 2000, the group acquired a 40 per cent. interest in a company, with Japan Telecom owning the other 60 per cent. interest, which holds a 74 per cent. interest in J-Phone Communications Co Limited (JPC). JPC in turn acquired controlling interests, averaging 51 per cent. in nine regional Japanese mobile phone J-Phone companies. These J-Phone companies merged into three larger regional companies during the year ended 31 March 2001. Japan Telecom also held a direct 18 per cent. interest, in the J-Phone companies.

During the year ended 31 March 2001, the group held an effective 23 per cent. interest in J-Phone. The impact of the combined J-Phone/Japan Telecom ownership structure, however, led the group to reflect 63 per cent. of the J-Phone results at the turnover and operating profit levels and all items below including interest and taxation, in accordance with the requirements of FRS 9. In May 2001, the group agreed to sell this interest (see note 29).

### (l) Japan Telecom

On 31 August 1999, the group completed its acquisition of a 30 per cent. interest, jointly with AT&T, in Japan Telecom, a leading Japanese telecommunications company. Japan Telecom is held through a BT subsidiary company, 66.7 per cent. BT owned and 33.3 per cent. AT&T owned. The group has a 20 per cent. economic interest. AT&T's economic interest is shown within the group's minority interests. Goodwill on this acquisition is being amortised over 20 years.

The acquisition of 30 per cent. interest in Japan Telecom comprised:

	£m
Group share of original book value of net assets	871
Fair value adjustment to achieve consistency of accounting policies	(49)
Fair value to the group	822
Goodwill	432
<b>Total cost</b>	<b>1,254</b>

On 31 March 2001, the 30 per cent. interest in Japan Telecom had a market value equivalent to £1,607 million (2000 — £3,398 million), compared with a carrying value of £1,282 million (2000 — £1,345 million). In April 2001, the group's direct interest in Japan Telecom was reduced to its 20 per cent. economic interest and in May 2001, the group agreed to sell this interest (see note 29).

### (m) AT&T Canada, Rogers Cantel Mobile Communications, SmarTone Mobile Communications and other investments

On 16 August 1999, the group acquired a 30 per cent. interest in an AT&T subsidiary undertaking which holds a 31 per cent. interest in AT&T Canada Corporation, a fixed-network telecommunications company operating in Canada. The resulting economic interest of 9.3 per cent. cost £360 million. On 31 March 2001, the 9.3 per cent. interest in AT&T Canada had a market value equivalent to £267 million (2000 — £477 million), compared with a carrying value of £352 million (2000 — £345 million). From 1 April 2000, the group decided it no longer exercised significant influence over this company and the investment was reclassified as an other investment.

On 16 August 1999, the group acquired jointly with AT&T an approximate 33 per cent. interest in Rogers Cantel Mobile Communications Inc, a cellular mobile phone company operating in Canada. The resulting economic interest of approximately 17 per cent. cost £299 million. On 31 March 2001, the 17 per cent. interest in Rogers Cantel Mobile Communications Inc had a market value of £191 million (2000 — £520 million), compared with a carrying value of £285 million (2000 — £298 million).

On 10 May 1999, the group acquired a 20 per cent. interest in SmarTone Mobile Communications Limited, a cellular mobile phone company operating in Hong Kong. On 31 March 2001, the 20 per cent. interest in SmarTone Mobile Communications Limited had a market value of £107 million (2000 — £277 million) compared with a carrying value of £243 million (2000 — £230 million). Goodwill arising on the acquisition of Rogers Cantel and SmarTone is being amortised over 20 years.

The acquisition of the interest in AT&T Canada, Rogers Cantel Mobile Communications, SmarTone Mobile Communications and other investments comprised:

	AT&T Canada £m	Rogers Cantel Mobile Communi- cations £m	Smartone Mobile Communi- cations £m	Other £m
Group share of original book value of net assets	101	11	96	34
Fair value adjustment to achieve consistency of accounting policies	—	—	—	—
Fair value to the group	101	11	96	34
Goodwill	259	288	145	51
<b>Total cost</b>	<b>360</b>	<b>299</b>	<b>241</b>	<b>85</b>

(n) **Maxis Communications and LG Telecom**

On 9 October 1998, the group completed its acquisition of a 33.3 per cent. interest in Maxis Communications, a leading Malaysian telecommunications company. On 14 October 1998, the group completed its acquisition of a 23.5 per cent. interest in LG Telecom, a major Korean mobile telecommunications company.

The acquisition of the interests in Maxis Communications and LG Telecom comprised:

	Maxis Communications £m	LG Telecom £m
Group share of original book value of net assets	60	98
Fair value adjustment to achieve consistency of accounting policies	(9)	(58)
Fair value to the group	51	40
Goodwill	228	194
<b>Total cost</b>	<b>279</b>	<b>234</b>

As stated in note 29, the group agreed in May 2001 to sell its interest in Maxis Communications.

(o) **Airtel Movil**

Following the clearance in 1998 by the European Commission of the alliance between the company, AirTouch and other investors in Airtel Movil SA, a leading Spanish mobile telecommunications company, the group's 15.8 per cent. investment in Airtel was reclassified as a joint venture on 1 April 1998. Airtel is jointly controlled by the company as a consequence of the alliance agreement. During the year ended 31 March 1999, the group acquired an additional 2 per cent. interest in Airtel for £55 million. Goodwill on this acquisition is being amortised over 20 years.

## Part 5: Financial information on BT and BT Group

In summary, the acquisition of the cumulative 17.8 per cent. interest in Airtel comprised:

	£m
Group share of original book value of net assets	62
Fair value adjustment to achieve consistency of accounting policies	(19)
Fair value to the group	43
Goodwill	158
<b>Total cost</b>	<b>201</b>

In May 2001, the group agreed to sell this interest (see note 29).

### (p) MCI Communications Corporation

In September 1994, the company completed the acquisition of a 20 per cent. equity interest in MCI (a major carrier of long-distance telecommunications services in the United States) represented by a holding of 136 million unlisted Class A common shares, whereupon MCI became the group's most significant associate. On 3 November 1996, the company entered into a merger agreement with MCI whereby the group would acquire the entire share capital of MCI, not already owned. On 21 August 1997, the terms of the merger agreement were modified. On 1 October 1997, WorldCom announced its intention to offer shares in its company to MCI shareholders as an alternative to the proposed merger and, following an improved offer from WorldCom on 9 November 1997, the company agreed with WorldCom and MCI that it would support the proposed merger of MCI with WorldCom. On 15 September 1998, MCI and WorldCom merged to form MCI WorldCom.

On completion of the merger, the company sold the group's holding of 136 million unlisted Class A common shares in MCI to WorldCom for US\$51 per share in cash. The consideration of US\$6,936 million was equivalent to £4,133 million at the exchange rate ruling on 15 September 1998. The group also held 0.7 million listed common shares in MCI, most of which were purchased in November 1995. These shares were exchanged for MCI WorldCom common shares on completion of the merger and subsequently sold in the market for £26 million.

As a consequence of the termination of the company's merger agreement with MCI and the company's agreement with WorldCom and MCI, the group ceased treating MCI as an associate on 31 October 1997. The group's share of its associates' results for the year ended 31 March 1998 included a loss before tax of £27 million for its share of MCI's results up to that date (1997 — £175 million profit).

At 31 March 1998, the group's investment in MCI was stated at £813 million. Goodwill, amounting to £2,214 million written off to group reserves in prior years in respect of this investment, was accounted for at the completion of the MCI/WorldCom merger in determining the profit on the sale of the shares which the group recognised (see note 7).

In the period 1 April 1997 to 31 October 1997, the group's turnover with MCI amounted to £108 million (1997 — £134 million) and in the same period the group purchased £56 million (1997 — £87 million) in services and products from MCI.

## 17. Net debt

	At 1 April 1998 £m	Cash flow £m	Other non-cash changes £m	Currency movement £m	At 31 March 1999 £m
<b>Analysis of net debt</b>					
Cash in hand and at bank	62	40	—	—	102
Overnight deposits	14	12	—	—	26
Bank overdrafts	(42)	15	—	1	(26)
	34	67	—	1	102
Other current assets investments	717	2,447	(1)	89	3,252
<b>Short-term investments and cash, less bank overdrafts</b>	<b>751</b>	<b>2,514</b>	<b>(1)</b>	<b>90</b>	<b>3,354</b>
Debt due within one year, excluding bank overdrafts	(839)	519	(574)	(27)	(921)
Debt due after one year	(3,889)	113	455	(65)	(3,386)
<b>Total debt, excluding bank overdrafts</b>	<b>(4,728)</b>	<b>632</b>	<b>(119)</b>	<b>(92)</b>	<b>(4,307)</b>
<b>Net debt</b>	<b>(3,977)</b>	<b>3,146</b>	<b>(120)</b>	<b>(2)</b>	<b>(953)</b>

  

	At 1 April 1999 £m	Cash flow £m	Acquisition or disposal of subsidiary undertakings £m	Other non-cash changes £m	Currency movement £m	At 31 March 2000 £m
<b>Analysis of net debt</b>						
Cash in hand and at bank	102	151	—	—	—	253
Overnight deposits	26	15	—	—	—	41
Bank overdrafts	(26)	(112)	—	—	—	(138)
	102	54	—	—	—	156
Other current assets investments	3,252	(1,236)	—	(5)	(1)	2,010
<b>Short-term investments and cash, less bank overdrafts</b>	<b>3,354</b>	<b>(1,182)</b>	<b>—</b>	<b>(5)</b>	<b>(1)</b>	<b>2,166</b>
Debt due within one year, excluding bank overdrafts	(921)	(3,968)	(348)	(199)	(76)	(5,512)
Debt due after one year	(3,386)	(1,432)	(623)	134	(47)	(5,354)
<b>Total debt, excluding bank overdrafts</b>	<b>(4,307)</b>	<b>(5,400)</b>	<b>(971)</b>	<b>(65)</b>	<b>(123)</b>	<b>(10,866)</b>
<b>Net debt</b>	<b>(953)</b>	<b>(6,582)</b>	<b>(971)</b>	<b>(70)</b>	<b>(124)</b>	<b>(8,700)</b>

## Part 5: Financial information on BT and BT Group

	At 1 April 2000 £m	Cash flow £m	Acquisition or disposal of subsidiary undertakings £m	Other non-cash changes £m	Currency movement £m	At 31 March 2001 £m
<b>Analysis of net debt</b>						
Cash in hand and at bank	253	159	—	—	—	412
Overnight deposits	41	(21)	—	—	—	20
Bank overdrafts	(138)	(10)	—	—	—	(148)
	156	128	—	—	—	284
Other current assets investments	2,010	480	48	16	(17)	2,537
<b>Short-term investments and cash, less bank overdrafts</b>	<b>2,166</b>	<b>608</b>	<b>48</b>	<b>16</b>	<b>(17)</b>	<b>2,821</b>
Debt due within one year, excluding bank overdrafts	(5,512)	(5,544)	(62)	(804)	(66)	(11,988)
Debt due after one year	(5,354)	(14,006)	(34)	562	57	(18,775)
<b>Total debt, excluding bank overdrafts</b>	<b>(10,866)</b>	<b>(19,550)</b>	<b>(96)</b>	<b>(242)</b>	<b>(9)</b>	<b>(30,763)</b>
<b>Net debt</b>	<b>(8,700)</b>	<b>(18,942)</b>	<b>(48)</b>	<b>(226)</b>	<b>(26)</b>	<b>(27,942)</b>

	2001 £m	2000 £m	1999 £m
<b>Reconciliation of net cash flow to movement in net debt</b>			
Increase in cash in the year	128	54	67
Cash (inflow) outflow from (increase) decrease in debt	(19,550)	(5,400)	632
Cash (inflow) outflow from (decrease) increase in liquid resources	480	(1,236)	2,447
Decrease (increase) in net debt resulting from cash flows	(18,942)	(6,582)	3,146
Currency and translation movements	(26)	(124)	(2)
Debt assumed on acquisitions	(48)	(971)	(94)
Other non-cash movements	(226)	(70)	(26)
Decrease (increase) in net debt in the year	(19,242)	(7,747)	3,024
Net debt at 1 April	(8,700)	(953)	(3,977)
<b>Net debt at 31 March</b>	<b>(27,942)</b>	<b>(8,700)</b>	<b>(953)</b>



## 18. Intangible assets

	Goodwill <sup>(a)</sup> £m	Telecommuni- cation licences <sup>(b)</sup> £m	Total £m
<b>Cost</b>			
At 1 April 1999	742	—	742
Additions	5,699	3	5,702
Disposals and transfers	(571)	—	(571)
Currency movements	(6)	—	(6)
Charge for the year	—	—	—
At 31 March 2000	5,864	3	5,867
Additions	—	4,315	4,315
Acquisitions of subsidiary undertakings	6,116	5,488	11,604
Adjustments	99	3	102
Disposals and transfers	(4)	—	(4)
Currency movements	35	(63)	(28)
<b>Total cost at 31 March 2001</b>	<b>12,110</b>	<b>9,746</b>	<b>21,856</b>
<b>Amortisation</b>			
At 1 April 1999	—	—	—
Charge for the year	89	1	90
At 31 March 2000	89	1	90
Charge for the year — amortisation	373	13	386
— impairment <sup>(c)</sup>	3,000	—	3,000
<b>Total amortisation at 31 March 2001</b>	<b>3,462</b>	<b>14</b>	<b>3,476</b>
<b>Net book value at 31 March 2001</b>	<b>8,648</b>	<b>9,732</b>	<b>18,380</b>
Net book value at 31 March 2000	5,775	2	5,777
Net book value at 31 March 1999	742	—	742

### Year ended 31 March 2001

- (a) The goodwill arising on acquisitions of subsidiary undertakings in the year ended 31 March 2001 mainly arose from the acquisition in June 2000 of the 50 per cent. interest in Telfort which the group did not already own (£986 million) and the acquisition in January and February 2001 of the 55 per cent. interest in Viag Interkom which the group did not already own (£4,992 million). The consideration for the acquisition of the 55 per cent. interest in Viag Interkom was negotiated in August 2000. (See note 16).
- (b) The telecommunication licences mainly comprise third generation mobile licences in the UK and Germany. In April 2000, the group won a third generation mobile licence in the UK government's auction. The licence, which cost £4,030 million, will be amortised over its remaining 20-year term from the date of launch of services using the licensed radio spectrum. In August 2000, Viag Interkom won a third generation mobile licence in the German government's auction. This licence, which cost £5,164 million, will be similarly amortised over its remaining 20-year term from the date of launch of service.
- (c) In accordance with FRS 11 (Impairment of fixed assets and goodwill), the carrying values of the group's subsidiary undertakings in Germany, Ireland, The Netherlands and the UK at 31 March 2001 have been compared to their recoverable amounts, represented by their value in use to the group.

The value in use has been derived from discounted cash flow projections which cover the ten years from 1 April 2001. The projections cover a ten year period as the directors consider that the growth in these businesses will exceed the average growth rate of the countries concerned over ten years. Also, the development of the technology and assets required for such growth means ten year projections would more fairly reflect their long-term values. After the ten year period, the projections use a long-term growth rate compatible with projections for the countries concerned. The discount rate used to arrive at this calculation was 10 per cent. on a pre-tax basis.

## Part 5: Financial information on BT and BT Group

The review has resulted in an exceptional charge to operating costs of £3,000 million in respect of Viag Interkom. The charge has been allocated to the goodwill arising on the acquisition of the remaining 55 per cent. interest in the company that was purchased during the year. The remaining goodwill of £1,921 million will be amortised over 20 years in accordance with the group's accounting policies.

During the year ended 31 March 2000, the acquisition of the interests in subsidiary companies and the consideration given comprised:

	Cellnet Group <sup>(a)</sup> £m	Esat <sup>(a)</sup> £m	Yellow Book USA <sup>(a)</sup> £m	Syntegra (USA) <sup>(a)</sup> £m	Other £m	Total £m
Minority interest	176	(2)	—	1	40	215
Fixed assets		428	6	12	157	603
Current assets		137	49	48	68	302
Current liabilities		(137)	(21)	(88)	(108)	(354)
Long-term liabilities		(487)	—	—	(62)	(549)
Provisions for liabilities and charges		—	—	—	(2)	(2)
Group share of original book value of net assets (liabilities)	176	(61)	34	(27)	93	215
Fair value adjustment to achieve consistency of accounting policies	—	(115)	—	—	—	(115)
Other fair value adjustments	—	(69)	—	—	—	(69)
Fair value to the group	176	(245)	34	(27)	93	31
Goodwill	2,997	1,765	381	240	316	5,699
<b>Total cost</b>	<b>3,173</b>	<b>1,520</b>	<b>415</b>	<b>213</b>	<b>409</b>	<b>5,730</b>
Consideration:						
Cash	3,014	179	401	213	327	4,134
Deferred	—	1,167	—	—	45	1,212
Loan notes 2000/2009	159	—	—	—	—	159
Other loan notes	—	174	14	—	14	202
Carrying value of associate wholly acquired	—	—	—	—	23	23
<b>Total</b>	<b>3,173</b>	<b>1,520</b>	<b>415</b>	<b>213</b>	<b>409</b>	<b>5,730</b>

Note:

(a) See note 16.

## 19. Tangible fixed assets

	Land and buildings(a) £m	Plant and equipment £m	Assets in course of construction £m	Total £m
<b>Cost</b>				
Balances at 1 April 1999	2,999	29,973	1,121	34,093
Acquisitions of subsidiary undertakings	29	480	26	535
Additions	37	786	2,844	3,667
Transfers	190	2,306	(2,496)	—
Disposals of subsidiary undertakings and transfers to joint ventures	(19)	(1,295)	(125)	(1,439)
Other disposals and adjustments	(101)	(955)	(137)	(1,193)
Balances at 31 March 2000	3,135	31,295	1,233	35,663
Acquisitions of subsidiary undertakings	87	1,924	188	2,199
Additions	40	998	3,951	4,989
Transfers	178	3,195	(3,373)	—
Other disposals and adjustments	40	(1,956)	(33)	(1,949)
<b>Total cost at 31 March 2001</b>	<b>3,480</b>	<b>35,456</b>	<b>1,966</b>	<b>40,902</b>
<b>Depreciation</b>				
Balances at 1 April 1999	1,375	14,917	—	16,292
Acquisitions of subsidiary undertakings	2	100	—	102
Charge for the year <sup>(i)</sup>	115	2,637	—	2,752
Disposals of subsidiary undertakings and transfers to joint ventures	—	(570)	—	(570)
Other disposals and adjustments	(68)	(942)	—	(1,010)
Balances at 31 March 2000	1,424	16,142	—	17,566
Acquisitions of subsidiary undertakings	22	438	—	460
Charge for the year	136	2,909	—	3,045
Other disposals and adjustments	(16)	(1,714)	—	(1,730)
<b>Total depreciation at 31 March 2001</b>	<b>1,566</b>	<b>17,775</b>	<b>—</b>	<b>19,341</b>
<b>Net book value at 31 March 2001</b>	<b>1,914</b>	<b>17,681</b>	<b>1,966</b>	<b>21,561</b>
Engineering stores	—	—	64	64
<b>Total tangible fixed assets at 31 March 2001</b>	<b>1,914</b>	<b>17,681</b>	<b>2,030</b>	<b>21,625</b>
Net book value at 31 March 2000	1,711	15,153	1,233	18,097
Engineering stores	—	—	66	66
<b>Total tangible fixed assets at 31 March 2000</b>	<b>1,711</b>	<b>15,153</b>	<b>1,299</b>	<b>18,163</b>
Net book value at 31 March 1999	1,624	15,056	1,121	17,801
Engineering stores	—	—	53	53
<b>Total tangible fixed assets at 31 March 1999</b>	<b>1,624</b>	<b>15,056</b>	<b>1,174</b>	<b>17,854</b>

*Note:*

(i) Includes impairment charge of £37 million (note 5).

## Part 5: Financial information on BT and BT Group

	2001 £m	2000 £m
<b>(a) The net book value of land and buildings comprised:</b>		
Freehold	1,514	1,327
Long leases (over 50 years unexpired)	170	182
Short leases	230	202
<b>Total net book value of land and buildings</b>	<b>1,914</b>	<b>1,711</b>
	2001 £m	2000 £m
<b>(b) Expenditure on tangible fixed assets comprised:</b>		
Plant and equipment		
Transmission equipment	2,295	1,563
Exchange equipment	479	413
Other network equipment	1,180	703
Computers and office equipment	574	502
Motor vehicles and other	251	257
Land and buildings	210	229
Increase (decrease) in engineering stores	(3)	13
<b>Total expenditure on tangible fixed assets</b>	<b>4,986</b>	<b>3,680</b>

## 20. Fixed asset investments

	Interests in associates and joint ventures <sup>(a)</sup>					Total £m
	Shares £m	Loans £m	Share of post acquisition profits (losses) £m	Other participating interests £m	Other invest- ments <sup>(b)</sup> £m	
<b>Cost</b>						
Balances at 1 April 1999	2,938	247	(662)	163	215	2,901
Additions	3,331	866	—	53	361	4,611
Disposals	—	—	—	—	(7)	(7)
Share of losses less retained profits for the year	—	—	(422)	—	—	(422)
Repayments and other transfers	(80)	(12)	15	(94)	57	(114)
Currency movements	58	(28)	20	—	(7)	43
<b>Balances at 31 March 2000</b>	<b>6,247</b>	<b>1,073</b>	<b>(1,049)</b>	<b>122</b>	<b>619</b>	<b>7,012</b>
Additions	1,882	3,955	—	66	199	6,102
Joint ventures becoming subsidiary companies	(2,718)	(3,321)	1,348	—	—	(4,691)
Disposals	(67)	—	12	—	(118)	(173)
Share of losses less retained profits for the year	—	—	(569)	—	—	(569)
Repayments and other transfers	(463)	(956)	—	(31)	367	(1,083)
Currency movements	195	(7)	(14)	—	26	200
<b>Balances at 31 March 2001</b>	<b>5,076</b>	<b>744</b>	<b>(272)</b>	<b>157</b>	<b>1,093</b>	<b>6,798</b>
<b>Provisions and amounts written off</b>						
Balances at 1 April 1999	(1,023)	—	—	—	(46)	(1,069)
Goodwill amortisation for the year	(84)	—	—	—	—	(84)
Disposals	—	—	—	—	2	2
Transfers	61	—	—	—	—	61
Increase in the year	—	—	—	—	(44)	(44)
<b>Balances at 31 March 2000</b>	<b>(1,046)</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(88)</b>	<b>(1,134)</b>
Goodwill amortisation for the year	(185)	—	—	—	—	(185)
Exceptional item relating to impairment in goodwill	(200)	—	—	—	—	(200)
Disposals	21	—	—	—	3	24
Transfers	24	—	—	—	(8)	16
Increase in the year	(6)	—	—	—	(109)	(115)
<b>Balances at 31 March 2001</b>	<b>(1,392)</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(202)</b>	<b>(1,594)</b>
<b>Net book value at 31 March 2001</b>	<b>3,684</b>	<b>744</b>	<b>(272)</b>	<b>157</b>	<b>891</b>	<b>5,204</b>
Net book value at 31 March 2000	5,201	1,073	(1,049)	122	531	5,878
Net book value at 31 March 1999	1,915	247	(662)	163	169	1,832

## Part 5: Financial information on BT and BT Group

### (a) Associates and joint ventures

	2001 £m	2000 £m
Associates:		
Goodwill	2,439	1,578
Loans	7	—
Share of other net assets (liabilities)	(217)	1,061
Total — associates	2,229	2,639
Joint ventures:		
Goodwill	526	728
Loans	737	1,073
Share of other net assets	664	785
Total — joint ventures	1,927	2,586
Net book value at 31 March	4,156	5,225

The group's proportionate share of its associates and joint ventures' assets and liabilities, in aggregate, at 31 March was as follows:

	2001 £m	2000 £m
Fixed assets	8,257	4,446
Current assets	5,726	1,833
Current liabilities	(7,398)	(1,656)
Net current assets (liabilities)	(1,672)	177
Non-current liabilities	(3,771)	(1,161)
Minority interests	(714)	(45)
Share of net assets	2,100	3,417

The group's proportionate share of its associates and joint ventures' losses less profits before taxation totalled £667 million (2000 — £476 million, 1999 — £367 million) and its share of their losses less profits attributable to shareholders totalled £895 million for the year ended 31 March 2001 (2000 — £521 million, 1999 — £379 million).

At 31 March 2001, the group had a 74.5 per cent. interest in e-escape Limited, a UK telecommunications service provider, having acquired an additional 25.5 per cent. on 19 December 2000. This additional interest was acquired with the intention of selling it to another investor and not for holding as a long-term investment. For this reason, the investment in this company has continued to be accounted for on the equity basis. For the year ended 31 March 2001, e-escape's turnover was £3 million and it incurred a loss after taxation of £9 million. Purchases from the group amounted to £3 million, and the balances due to the group at 31 March 2001 was £12 million. The net book value of the investment in e-escape is £nil at 31 March 2001.

### (b) Other investments

Other investments include ordinary shares of the company, with a net book value of £97 million (2000 — £117 million) and a market value of £97 million (2000 — £227 million), held in trust for the BT Incentive Share Scheme, the BT Retention Share Scheme, the BT Executive Share Plan, the BT Performance Share Plan and the BT Deferred Bonus Plan (note 33). They also include ordinary shares of the company, with a net book value of £64 million and a market value of £122 million, held in trust for employee sharesave schemes. In the group balance sheet at 31 March 2001, listed investments were held with a book value of £588 million (2000 — £297 million) and a market value of £489 million (2000 — £775 million).

## 21. Debtors

	2001 £m	2000 £m
Trade debtors <sup>(a)</sup>	3,379	2,487
Amounts owed by subsidiary undertakings	—	—
Amounts owed by joint ventures (trading)	532	602
Amounts owed by associates (trading)	5	6
Other debtors	506	596
Accrued income	1,420	1,298
Prepayments	418	252
<b>Total debtors</b>	<b>6,260</b>	<b>5,241</b>

*Note:*

(a) The group's trade debtors are stated after deducting £487 million (2000 — £421 million) for doubtful debts. The amount charged to the group profit and loss account for doubtful debts for the year ended 31 March 2001 was £227 million (2000 — £264 million, 1999 — £231 million).

## 22. Current asset investments

	2001 £m	2000 £m
Listed investments	85	419
Short-term loans to subsidiary undertakings	—	—
Other short-term deposits and investments	2,472	1,632
<b>Total current asset investments</b>	<b>2,557</b>	<b>2,051</b>
Market value of listed investments	85	420

## Part 5: Financial information on BT and BT Group

### 23. Loans and other borrowings

	2001 £m	2000 £m
US dollar 8.625 per cent. notes 2030 <sup>(a)</sup>	1,928	—
5.75 per cent. bonds 2028 (less unamortised discount £4 million (2000 — £5 million))	596	595
3.5 per cent. indexed linked notes 2025 (less unamortised discount of £5 million)	252	—
8.625 per cent. bonds 2020 (less unamortised discount £4 million (2000 — £4 million))	296	296
7.5 per cent. notes 2016 <sup>(a)</sup> (less unamortised discount of £10 million)	690	—
Euro 6.875 per cent. notes 2011 <sup>(a)</sup> (less unamortised discount of £14 million)	1,385	—
US dollar 8.125 per cent. notes 2010 <sup>(a)</sup>	2,073	—
US dollar 8.765 per cent. bonds 2009	141	125
Euro 11.875 per cent. senior notes 2009 (including unamortised premium £26 million (2000 — £28 million))	134	133
US dollar 11.875 per cent. senior notes 2008 (including unamortised premium £13 million (2000 — £17 million))	126	112
US dollar 12.5 per cent. senior deferred coupon notes 2007 (less unamortised discount £3 million (2000 — £13 million))	138	116
US dollar 7 per cent. notes 2007 (less unamortised discount £3 million (2000 — £3 million))	605	624
12.25 per cent. bonds 2006	229	229
7.125 per cent. notes 2006 <sup>(a)</sup> (less unamortised discount of £4 million)	396	—
Euro 6.125 per cent. notes 2006 <sup>(a)</sup> (less unamortised discount of £10 million)	1,855	—
US dollar 7.625 per cent. notes 2005 <sup>(a)</sup>	2,140	—
US dollar 6.75 per cent. bonds 2004	604	627
Euro 5.625 per cent. notes 2004 <sup>(a)</sup> (less unamortised discount of £5 million)	1,083	—
US dollar floating rate notes 2003 <sup>(a)</sup>	761	—
12.25 per cent. bonds 2003	180	180
7.125 per cent. bonds 2003 (less unamortised discount £1 million (2000 — £2 million))	499	498
Euro floating rate notes 2003 <sup>(a)</sup> (less unamortised discount of £3 million)	619	—
US dollar 6.75 per cent. notes 2002 (less unamortised discount £3 million (2000 — £5 million))	907	936
<b>Total listed bonds, debentures and notes</b>	<b>17,637</b>	<b>4,471</b>
Lease finance	270	9
Bank loans due 2000-2009 (average effective interest rate 9.6%)	637	827
Euro floating rate note 2000-2005	204	172
Floating rate note 2000-2009 (average effective interest rate 5.4%)	141	159
Other loans	268	245
Bank overdrafts and other short-term borrowings	1,041	237
Euro Medium Term Notes	7,219	—
Commercial paper	3,494	4,884
<b>Total loans and other borrowings</b>	<b>30,911</b>	<b>11,004</b>

#### Note:

- (a) The interest rate payable on these notes will be subject to adjustment from time to time if either Moody's or Standard and Poor's (S&P) reduces the rating ascribed to the group's senior unsecured debt below A3 in the case of Moody's or below A minus in the case of S&P. In this event, the interest rate payable on the notes and the spread applicable to the floating notes will be increased by 0.25 per cent. for each ratings category adjustment by each ratings agency. In addition, if Moody's or S&P subsequently increase the rating ascribed to the group's senior unsecured debt, then the interest rate then payable on notes and the spread applicable to the floating notes will be decreased by 0.25 per cent. for each rating category upgrade by each rating agency, but in no event will the interest rate be reduced below the initial interest rate reflected in the table above.



Apart from the lease finance all borrowings at 31 March 2001 are unsecured. Lease finance is repayable by instalments.

	2001 £m	2000 £m
Repayments fall due as follows:		
Within one year, or on demand	12,136	5,650
Between one and two years	1,933	12
Between two and three years	2,430	1,225
Between three and four years	869	589
Between four and five years	4,245	895
After five years	9,298	2,633
Total due for repayment after more than one year	18,775	5,354
<b>Total loans and other borrowings</b>	<b>30,911</b>	<b>11,004</b>

The effect of the change in the group's accounting policy relating to the group's loans and borrowings as disclosed in note 1, is that the total loans and other borrowings disclosed at 31 March 2001 are £170 million lower than they would be prior to this change. Prior to the change in policy the total loans and other borrowings would be £31,081 million.

#### 24. Other creditors

	2001 £m	2000 £m
Trade creditors	3,287	2,416
Amounts owed to joint ventures (trading)	504	747
Corporation taxes	625	757
Other taxation and social security	379	377
Other creditors <sup>(a)</sup>	1,603	2,556
Accrued expenses	948	558
Deferred income	1,251	963
Dividends	—	861
<b>Total other creditors</b>	<b>8,597</b>	<b>9,235</b>

Note:

(a) Includes Esat purchase consideration of £1,167 million at 31 March 2000.

## Part 5: Financial information on BT and BT Group

### 25. Provisions for liabilities and charges

	Deferred taxation(a) £m	Pension provisions £m	Other provisions(b) £m	Total £m
Balances at 1 April 1999	350	953	88	1,391
Charged (credited) against profit for the year	13	167	(11)	169
Acquisitions and disposals	(9)	—	—	(9)
Utilised in the year	—	(491)	(4)	(495)
Balances at 31 March 2000	354	629	73	1,056
Charged (credited) against profit for the year	(84)	326	52	294
Utilised in the year	—	(620)	(7)	(627)
<b>Total provisions at 31 March 2001</b>	<b>270</b>	<b>335</b>	<b>118</b>	<b>723</b>

#### (a) Deferred taxation

The elements of deferred taxation provided in the accounts at 31 March were as follows:

	2001 £m	2000 £m
Tax effect of timing differences due to:		
Excess capital allowances	439	613
Pension provisions	(102)	(189)
Other	(67)	(70)
<b>Total provision for deferred taxation</b>	<b>270</b>	<b>354</b>

The total potential liability to deferred taxation at 31 March was as follows:

	2001 £m	2000 £m
Tax effect of timing differences due to:		
Excess capital allowances	2,454	2,568
Pension provisions	(102)	(189)
Other	(67)	(70)
<b>Total potential liability for deferred taxation</b>	<b>2,285</b>	<b>2,309</b>

(b) Other provisions comprise amounts provided for legal or constructive obligations arising from insurance claims and litigation.

## 26. Called up share capital

The authorised share capital of the company throughout the year ended 31 March 2001 and 31 March 2000 was £2,625,000,001 divided into 10,500,000,004 ordinary shares of 25p each.

The allotted, called up and fully paid share capital of the company was £1,646 million at 31 March 2001 (2000 — £1,627 million), representing 6,585,228,408 ordinary shares (2000 — 6,507,104,882 ordinary shares).

Of the authorised but unissued share capital at 31 March 2001, 192 million ordinary shares were reserved to meet options granted under the employee share option schemes described in note 33.

Ordinary shares allotted during the two years to 31 March 2001, were as follows:

	Number	Nominal value £m	Consideration <sup>(a)</sup> £m
Savings related schemes	35,762,240	9	119
Other share option schemes	1,138,560	—	4
Stock purchase plan	769,039	—	4
<b>Totals for the year ended 31 March 2000</b>	<b>37,669,839</b>	<b>9</b>	<b>127</b>
Savings related schemes <sup>(b)</sup>	69,999,933	17	145
BT Employee Share Ownership Scheme	7,117,008	2	59
Other share option schemes	881,470	—	3
Stock purchase plan	125,115	—	1
<b>Totals for the year ended 31 March 2001</b>	<b>78,123,526</b>	<b>19</b>	<b>208</b>

*Notes:*

(a) Consideration excludes contributions from group undertakings as described in note 27(c).

(b) Includes shares held in trust in anticipation of a vesting under BT's share schemes (note 33).

## Part 5: Financial information on BT and BT Group

### 27. Reconciliation of movement in shareholders' funds

	Share capital £m	Share premium account <sup>(a)</sup> £m	Capital redemption reserve <sup>(a)</sup> £m	Other reserves <sup>(a)</sup> £m	Profit and loss account £m	Total £m
Balances at 31 March 1998	1,603	892	749	27	7,514	10,785
Goodwill, previously written off to reserves, taken back to the profit and loss account (note 7)	—	—	—	—	2,214	2,214
Employee share option schemes — 50 million shares issued <sup>(c)</sup> (note 33)	12	314	—	—	—	326
Movement relating to BT's employee share ownership trust <sup>(c)</sup>	—	—	—	—	(165)	(165)
Currency movements (including £22 million net losses in respect of foreign currency borrowings) <sup>(d)</sup>	—	—	—	—	45	45
Profit for the financial year	—	—	—	—	2,983	2,983
Dividends (18.3p per ordinary share)	—	—	—	—	(1,322)	(1,322)
Scrip dividend — 8 million shares issued	2	—	(2)	—	74	74
Balances at 31 March 1999	1,617	1,206	747	27	11,343	14,940
Goodwill, previously written off to reserves, taken back to the profit and loss account <sup>(b)</sup>	—	—	—	—	6	6
Employee share option schemes — 38 million shares issued <sup>(c)</sup> (note 33)	10	374	—	—	—	384
Movement relating to BT's employee share ownership trust <sup>(c)</sup>	—	—	—	—	(257)	(257)
Currency movements (including £10 million net losses in respect of foreign currency borrowings) <sup>(d)</sup>	—	—	—	—	(66)	(66)
Profit for the financial year	—	—	—	—	2,055	2,055
Dividends (19.6p per ordinary share)	—	—	—	—	(1,426)	(1,426)
Unrealised gain on transfer of assets and group undertakings to a joint venture	—	—	—	159	—	159
Balances at 31 March 2000	1,627	1,580	747	186	11,655	15,795
Employee share option schemes — 78 million shares issued <sup>(c)</sup> (note 33)	19	615	—	—	—	634
Movement relating to BT's employee share ownership trust <sup>(c)</sup>	—	—	—	—	(359)	(359)
Currency movements (including £65 million net gain in respect of foreign currency borrowings) <sup>(d)</sup>	—	—	—	—	429	429
Loss for the financial year	—	—	—	—	(1,810)	(1,810)
Dividend (7.8p per ordinary share)	—	—	—	—	(571)	(571)
Adjustment to unrealised gain on transfer of assets and group undertakings to a joint venture	—	—	—	(49)	—	(49)
<b>Balances at 31 March 2001</b>	<b>1,646</b>	<b>2,195</b>	<b>747</b>	<b>137</b>	<b>9,344</b>	<b>14,069</b>

#### Notes:

- (a) The share premium account, representing the premium on allotment of shares, the capital redemption reserve and £110 million of the other reserves are not available for distribution.
- (b) Aggregate goodwill at 31 March 2001 in respect of acquisitions completed prior to 1 April 1998 of £1,383 million (2000 — £1,383 million, 1999 — £1,389 million) has been written off against retained earnings in accordance with the group's accounting policy. The goodwill written off against retained earnings will be charged in the profit and loss account on the subsequent disposal of the business to which it related.
- (c) During the year ended 31 March 2001 the company issued shares at a market value of £400 million (2000 — £375 million) in respect of the exercise of options awarded under its principal savings-related share option scheme. Employees paid £145 million (2000 — £118 million) to the group for the issue of these shares and the balance of £255 million (2000 — £257 million) comprised contributions to the qualifying employee share ownership trust from group undertakings. In addition the company issued shares at a market value of £171 million to the qualifying employee share ownership trust in anticipation of the exercise of share options in August 2001 paid for by contributions to the trust from group undertakings, these shares were written down by £96 million to the option exercise price as part of the movement relating to the employee share ownership trust.
- (d) The cumulative foreign currency translation adjustment, which increased retained earnings at 31 March 2001, was £278 million (2000 — £151 million decrease, 1999 — £85 million decrease).

### 28. Related party transactions with associates and joint ventures

In the year ended 31 March 2001, the group's turnover with Concert amounted to £804 million (2000 — £181 million) and it purchased £612 million (2000 — £170 million) in services and products from Concert. In addition, the group provided certain support services to Concert, including the secondment of staff, which totalled £168 million (2000 — £79 million) and is shown as other operating income. Interest for the year of £41 million (2000 — £12 million) was receivable on long-term debt due from Concert at a rate of 6.5%. The

amount of debt outstanding at 31 March 2001 was £651 million (2000 — £665 million). The maximum debt outstanding during the year was £674 million (2000 — £665 million). As at the latest practicable date, 30 April 2001, the balance of the loan was £636 million. During the year ended 31 March 2000, Concert Communications' net outflow from operations was £18 million and its purchase of tangible fixed assets was £106 million. Comparative figures for 2000 are for the period from the formation of the joint venture on 5 January 2000 to 31 March 2000.

In the year ended 31 March 2001, the group's turnover with its other associates and joint ventures amounted to £21 million (2000 — £64 million, 1999 — £129 million) and the group purchased £63 million (2000 — £nil million, 1999 — £1 million) in services and products from these undertakings. Interest for the year of £81 million (2000 — £8 million) was receivable on debt due from these undertakings. Interest was charged on debt at a rate of 6%. The amount of debt outstanding with these joint ventures, at 31 March 2001, was £73 million (2000 — £408 million). The maximum debt outstanding during the year was £3,332 million (2000 — £442 million). As at the latest practicable date, 30 April 2001, the amount of debt outstanding was £46 million.

## 29. Financial commitments, contingent liabilities and subsequent events

	2001 £m	2000 £m
Contracts placed for capital expenditure not provided in the accounts	<b>1,231</b>	1,000
Operating lease payments payable within one year of the balance sheet date were in respect of leases expiring:		
Within one year	7	9
Between one and five years	32	37
After five years	110	140
<b>Total payable within one year</b>	<b>149</b>	<b>186</b>

Future minimum operating lease payments for the group at 31 March 2000 were as follows:

	2000 £m
Payable in the year ending 31 March:	
2001	186
2002	173
2003	166
2004	160
2005	152
Thereafter	997
<b>Total future minimum operating lease payments</b>	<b>1,834</b>

Future minimum operating lease payments for the group at 31 March 2001 were as follows:

	2001 £m
Payable in the year ending 31 March:	
2002	149
2003	139
2004	131
2005	121
2006	113
Thereafter	816
<b>Total future minimum operating lease payments</b>	<b>1,469</b>

Operating lease commitments were mainly in respect of leases of land and buildings.

At 31 March 2000 and 31 March 2001, there were no contingent liabilities or guarantees other than those arising in the ordinary course of the group's business and on these no material losses are anticipated. The group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations. Otherwise, the group generally carries its own risks.

## Part 5: Financial information on BT and BT Group

The company has guaranteed certain borrowings of subsidiary undertakings amounting to £974 million (2000 — £926 million). The company has provided guarantees amounting to £1,160 million at 31 March 2001, in respect of bank loans and guarantees provided to associates and joint ventures, including £782 million relating to J-Phone Communications.

Satellite consortia, in which the company has participating interests, are organisations without limited liability. At 31 March 2001, the company's share of the aggregate borrowings of these consortia amounted to £100 million (2000 — £130 million).

The company does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the group.

On 27 April 2000, BT acquired a third generation mobile licence for the UK in HM Government's auction, for £4.03 billion. BT paid the fee in full on 16 May 2000 by drawing on its commercial paper programmes.

### Subsequent events

In April 2001, the group acquired the 49.5 per cent. of Esat Digifone that was not already owned, from Telenor, for £856 million under an agreement made in early 2000.

On 2 May 2001, BT announced that it had agreed to sell its interests in Japan Telecom and J-Phones for £3.7 billion, and its interest in Airtel in Spain for £1.1 billion, both to Vodafone. The impact of the combined transaction will be a net reduction in total group debt of £4.4 billion. Completion of the transactions is conditional upon relevant regulatory and procedural approvals in Europe and Japan.

On 4 May 2001, BT also announced that it had agreed in principle to sell its interest in Maxis Communications in Malaysia for £350 million. This transaction is also subject to regulatory and other approvals.

On 10 May 2001, BT announced that it proposed to raise approximately £5.9 billion, net of expenses, by the issue of up to 1,975,580,052 new ordinary shares at a price of 300 pence per share. The issue is being made by way of a rights issue on the basis of 3 new ordinary shares for every 10 existing ordinary shares held on 9 May 2001. The rights issue closed on 15 June 2001.

### 30. Pension costs

The total pensions cost of the group expensed within staff costs was £326 million (2000 — £167 million, 1999 — £176 million), of which £315 million (2000 — £159 million, 1999 — £167 million) related to the group's main pension scheme, the BT Pension Scheme (BTPS). The increase in cost in the year ended 31 March 2001 was mainly attributable to the general trend towards longer life expectancy and a smaller amortisation of the combined pension fund position and pension provision held in the group balance sheet.

The pension cost for the year ended 31 March 2001 was based on the valuation of the BTPS at 31 December 1999. The pension costs for the years ended 31 March 2000 and 1999 were based on the valuation of the BTPS at 31 December 1996. The valuations, carried out by professionally qualified independent actuaries, used the projected unit method. The valuations were determined using the following long-term assumptions:

	Rates (per annum)	
	1999 valuation %	1996 valuation %
Return on existing assets, relative to market values	5.45	7.95
(after allowing for a real increase in dividends of)	1.00	0.75
Return on future investments	7.12	8.42
Average increase in retail price index	3.00	4.00
Average future increases in wages and salaries	4.80	5.82
Average increase in pensions	3.00	3.75-4.00

At 31 December 1999, the assets of the BTPS had a market value of £29,692 million and, taking account of the special contribution by the company in March 2000, were sufficient to cover 96.8 per cent. of the benefits that had accrued to members by that date, after allowing for expected future increases in wages and salaries but not taking into account the costs of providing incremental pension benefits for employees taking early retirement under release schemes since that date. This cost, which amounted to £429 million in the year ended 31 March 2001, will be taken into account in the next actuarial valuation being undertaken at 31

December 2000. The costs for the previous financial years (2000 – £140 million, 1999 — £279 million) were taken into account in the 31 December 1999 valuation.

For the purpose of determining the group's pension expenses in the year ended 31 March 2001, the same assumptions were used as set out above for the December 1999 valuation, with the exception that, over the long term, it has been assumed that the return on the existing assets of the scheme, relative to market values, would be 5.6 per cent. per annum (allowing for real equity dividend growth of 1.25 per cent. per annum).

In the year ended 31 March 2001, the group made regular contributions of £308 million (2000 — £253 million, 1999 — £239 million) and special contributions of £300 million (2000 — £230 million, 1999 — £200 million).

Certain activities of the BTPS are carried out at the company's pension centre, all costs of which are borne by the company. These costs have not been apportioned for accounting purposes between those attributable to the BTPS and those attributable to the company because functions maintained for both entities cannot be meaningfully divided between them. The company occupies nine properties owned by the scheme on which an annual rental of £3 million is payable. The BTPS assets are invested in UK and overseas equities, UK and overseas properties, fixed interest and index linked securities, deposits and short-term investments. At 31 March 2001, the UK equities included 51 million (2000 — 51 million) ordinary shares of the company with a market value of £258 million (2000 — £597 million).

Following a High Court judgement made in October 1999, the BTPS is liable to pay additional benefits to certain former employees of the group who left on voluntary redundancy terms. These were former employees, in managerial grades, who had joined the group's business prior to 1 December 1971. The value of the additional benefits at 31 March 2001 is estimated at £200 million. The actuarial valuation at 31 December 1999 took into account the cost of these additional benefits.

On 26 April 2001, an application for permission to appeal against the judgement was lodged on behalf of certain former employees in non-managerial grades in an attempt to extend the additional benefits to those grades. The company will be strongly resisting this new claim if permission to appeal is given.

### 31. Directors

#### Directors' emoluments

The emoluments of the directors for the year ended 31 March 2001 and the benefits received under the long-term incentive plans were, in summary, as follows:

	2001 £000	2000 £000	1999 £000
Salaries	2,199	1,878	1,695
Performance-related bonus	1,036	1,295	1,515
Deferred bonus in shares	531	573	1,513
Other benefits	182	148	123
	<b>3,948</b>	<b>3,894</b>	<b>4,846</b>
Payments to non-executive directors <sup>(a)</sup>	<b>388</b>	<b>302</b>	<b>283</b>
<b>Total emoluments</b>	<b>4,336</b>	<b>4,196</b>	<b>5,129</b>
Gain on the exercise of share options <sup>(b)</sup>	—	—	932
Value of shares vested under the Executive Share Plan and the Performance Share Plan <sup>(c)(d)</sup>	<b>782</b>	<b>1,845</b>	—

#### Notes:

- (a) Payments to non-executive directors include fees paid to their principal employer of £nil (2000 — £nil, 1999 — £9,500).
- (b) The amount for the year ended 31 March 1999 includes £41,000 attributable to a former director.
- (c) The amount for the year ended 31 March 2000 includes £834,000 attributable to a former director.
- (d) The amount for the year ended 31 March 2001 is entirely attributable to former directors.

More detailed information concerning directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown below.

## Part 5: Financial information on BT and BT Group

### Remuneration

Directors' remuneration (excluding pension arrangements and deferred bonuses) was as follows:

	Salary and fees			Annual and special bonus			Benefits excluding pension <sup>(a)</sup>			Total <sup>(e)</sup>		
	2001 £000	2000 £000	1999 £000	2001 £000	2000 £000	1999 £000	2001 £000	2000 £000	1999 £000	2001 £000	2000 £000	1999 £000
Sir Iain Vallance	342	308	349	125	400	300	51	38	45	518	746	694
Sir Peter Bonfield	780	725	617	481	500	725	50	53	37	1,311	1,278	1,379
P R Hampton <sup>(b)</sup>	181	—	—	100	—	—	5	—	—	286	—	—
R P Brace <sup>(c)</sup>	380	355	329	130	145	210	31	24	26	541	524	565
B Cockburn <sup>(d)</sup>	516	490	400	200	250	280	45	33	15	761	773	695
Lord Marshall	75	75	75	—	—	—	—	—	—	75	75	75
Sir Anthony Greener	25	—	—	—	—	—	—	—	—	25	—	—
H Alexander	35	35	24	—	—	—	—	—	—	35	35	24
J I W Anderson	57	54	46 <sup>(f)</sup>	—	—	—	—	—	—	57	54	46
L R Hughes	32	8	—	—	—	—	—	—	—	32	8	—
N Isdell	39	32	22	—	—	—	—	—	—	39	32	22
J F de Moller	35	20	—	—	—	—	—	—	—	35	20	—
J K Oates	30	40	36	—	—	—	—	—	—	30	40	36
M van den Bergh	22	—	—	—	—	—	—	—	—	22	—	—
Sir John Weston	38	38	16	—	—	—	—	—	—	38	38	16
M Argent	—	—	30	—	—	—	—	—	1	—	—	31
Sir Ewen Fergusson	—	—	33	—	—	—	—	—	—	—	—	33
	<b>2,587</b>	<b>2,180</b>	<b>1,977</b>	<b>1,036</b>	<b>1,295</b>	<b>1,515</b>	<b>182</b>	<b>148</b>	<b>124</b>	<b>3,805</b>	<b>3,623</b>	<b>3,616</b>

#### Notes:

- (a) Includes other benefits as described above. Sir Iain Vallance had use of a car in Scotland.
- (b) Philip Hampton joined the company on 1 November 2000.
- (c) On the terms of his leaving the company on 31 December 2000, Robert Brace continued to receive his salary and contractual benefits until the earlier of twelve months or until he obtained full-time employment. On 31 March 2001, these payments were discontinued when he was appointed to a new position. Between 31 December 2000 and 31 March 2001, salary of £95,000 was paid to Robert Brace, together with benefits to the value of £5,000. In addition, Robert Brace was paid a sum of £200,000, which was the estimated cost of providing the pension benefits that would have accrued over his notice period.
- (d) On the terms of his leaving the company on 31 March 2001, Bill Cockburn will continue to receive his salary and value of his contractual benefits until the earlier of twelve months or until he obtains full-time employment.
- (e) In addition deferred bonuses, payable in shares in three years' time, were awarded to: Sir Peter Bonfield £481,000 (2000 — £500,000, 1999 — £1,150,000); Philip Hampton £50,000; Robert Brace — £nil (2000 — £72,500, 1999 — £82,500); Bill Cockburn — £nil (2000 — £nil, 1999 — £280,000). When added to the amounts paid or currently payable for the 2001 financial year, in the table above, the total remuneration of Sir Peter Bonfield was £1,792,000 (2000 — £1,778,000, 1999 — £2,529,000); Robert Brace £nil (2000 — £596,500, 1999 — £647,500); Bill Cockburn £nil (2000 — £773,000, 1999 — £975,000) and Philip Hampton £336,000.
- (f) Payments to non-executive directors include fees paid to their principal employer of £nil (2000 — £nil, 1999 — £9,500).

The directors' long-term remuneration benefits, through the exercise of share options, the ESP and the PSP, were as follows:

	ESP	ESP	PSP	Share options	Total		
	2001 £000	2000 £000	2000 £000	1999 £000	2001 £000	2000 £000	1999 £000
R P Brace	361	695	—	891	361	695	891
B Cockburn	—	—	316	—	—	316	—
Sir Alan Rudge	421	834	—	41	421	834	41
	<b>782</b>	<b>1,529</b>	<b>316</b>	<b>932</b>	<b>782</b>	<b>1,845</b>	<b>932</b>

The figures for share options in the above table are based on the amount by which the market value of the shares on the date of exercise exceeded the options price. The figures include employee compensation for the special dividend paid in September 1998. The figures for the ESP and PSP are based on the value of the awards of shares on the vesting dates. Sir Alan Rudge retired as a director on 31 October 1997. Yve Newbold, who retired in June 1997, remains on the *Community Support Committee*, for which she received fees of £5,000 in the 2001 financial year (2000 — £5,000, 1999 — £5,000).



## **Pensions**

Sir Peter Bonfield's pension arrangements provide for a pension of two-thirds of his final salary at age 60, inclusive of any retained benefits from his previous employment, and a widow's pension of two-thirds of his pension. He would have been entitled to a pension of 57 per cent. of salary if he had retired on 31 March 2001. If his retirement occurs before 2004, the percentage of salary used to calculate the pension will increase on a uniform basis to the target level at 60. His benefits are provided through a non-approved unfunded arrangement.

Philip Hampton's pension accrues at the rate of one thirtieth of his final salary for each year of service. In addition, a two-thirds widow's pension would be payable on his death. He is a member of the BT Pension Scheme, but as he is subject to the earnings cap, which is a restriction on the amount of pay which can be used to calculate pensions due from a tax approved pension scheme, the company has agreed to increase his benefits to the target level by means of a non-approved, unfunded arrangement.

Bill Cockburn left the company on 31 March 2001 and his deferred pension was increased to the level it would have been at had he remained in service until age 60. In addition, there would be no actuarial reduction if the deferred pension was to come into payment within eleven months before his 60th birthday.

Robert Brace left the company on 31 December 2000 at which time his pension ceased to accrue.

While Sir Iain Vallance was part-time Chairman and subsequently as President Emeritus, he is a deferred member of the BT Pension Scheme. He is currently receiving a pension, being paid by the company, which in the 2001 financial year amounted to £344,177 (2000 — £340,433, 1999 — £222,222 from 1 August 1998). Sir Iain's pension arrangements entitle his surviving widow to his full pension until July 2003 and to two-thirds of his pension after that date.

## Part 5: Financial information on BT and BT Group

The table below shows the increase in the accrued benefits to which each director has become entitled during the year and the transfer value of the increase in accrued benefit:

	Increase in accrued pension during year or to date of retirement in year <sup>(a)</sup>			Total accrued pension at year end or at date of retirement, if earlier <sup>(b)</sup>			Transfer value of increase in accrued benefit <sup>(c)</sup>		
	2001 £000	2000 £000	1999 £000	2001 £000	2000 £000	1999 £000	2001 £000	2000 £000	1999 £000
Sir Iain Vallance <sup>(d)</sup>	N/A	N/A	1	N/A	N/A	333	N/A	N/A	5
Sir Peter Bonfield	37	119	30	235	192	72	683	2,204	500
P R Hampton	6	—	—	6	—	—	66	—	—
R P Brace	9	17	17	150	137	118	118	246	205
B Cockburn	52	17	15	94	41	23	963	317	258

### Notes:

- The increase in accrued pension during the year excludes any increase for inflation.
- The pension entitlement is that which would be paid annually on retirement at normal retirement age based on service to the end of the year or date of retirement, if earlier.
- The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes directors' contributions. The transfer value represents a liability of the company rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration, as it is not money the individual is entitled to receive.
- Based on service to 31 July 1998, after which no further pension entitlements accrue.

### Directors' interests

The interests of directors and their families in the company's shares at 31 March 2001, 1 April 2000 and 1 April 1999, or date of appointment if later, are shown below:

Beneficial holdings	No. of shares		
	2001	2000	1999
Sir Iain Vallance	208,570	208,504	208,452
Sir Peter Bonfield	10,862 <sup>(a)</sup>	10,583 <sup>(a)</sup>	9,465 <sup>(a)</sup>
P R Hampton	780	780 <sup>(b)</sup>	—
R P Brace	—	184,004 <sup>(a)</sup>	144,283 <sup>(a)</sup>
B Cockburn	22,940	22,865	4,181
Lord Marshall	2,000	2,000	2,000
Sir Anthony Greener	8,936	3,936 <sup>(b)</sup>	—
H Alexander	930	930	—
J I W Anderson	5,910	5,910	4,155
L R Hughes	6,800	2,100	2,100 <sup>(b)</sup>
N Isdell	7,500	2,500	2,000
J F de Moller	1,500	1,500	1,500 <sup>(b)</sup>
J K Oates	—	3,944	3,878
M van den Bergh	1,000	— <sup>(b)</sup>	—
Sir John Weston	1,046	1,030	1,008
<b>Total</b>	<b>278,774</b>	<b>450,586</b>	<b>383,022</b>

### Notes:

- Includes 9,606 shares (2000 — 9,393 shares, 1999 — 9,245 shares) purchased and held by Sir Peter Bonfield and nil shares (2000 — 15,005 shares, 1999 — 22,200 shares) by Robert Brace in the ESP (see note 33 to the financial statements).
- At date of appointment.

Details of share options held at 31 March 2001 are as follows:

	Number of shares under option					31 March 2001	Option exercise price per share	Market price at date of exercise	Usual date from which exercisable	Usual expiry date
	1 April 1998	Granted	Exercised	31 March 1999 and 2000	Lapsed					
Sir Iain Vallance	57,957	—	—	57,957	—	<b>57,957</b>	333p	09/03/95	09/03/02	
	20,770	—	—	20,770	—	<b>20,770</b>	430p	04/03/96	04/03/03	
	3,760	—	—	3,760	—	<b>3,760</b>	375p	08/12/97	08/12/04	
	<b>82,487</b>	—	—	<b>82,487</b>	—	<b>82,487</b>				
Sir Peter Bonfield	6,460	—	—	6,460	—	<b>6,460</b>	267p	14/08/01	14/02/02	
R P Brace	136,890	—	136,890 <sup>(b)</sup>	—	—	—	263p	734p	06/09/92	06/09/99
	18,680	—	18,680 <sup>(b)</sup>	—	—	—	289p	734p	07/12/93	07/12/00
	18,020	—	18,020 <sup>(b)</sup>	—	—	—	333p	734p	09/03/95	09/03/02
	24,890	—	—	24,890	—	<b>24,890</b>	430p		04/03/96	04/03/03
	30,180	—	—	30,180	—	<b>30,180</b>	460p		15/11/96	15/11/03
	23,470	—	—	23,470	—	<b>23,470</b>	375p		08/12/97	08/12/04
	2,265	—	2,265 <sup>(c)</sup>	—	—	—	320p	817.5p	14/06/98	14/12/98
	3,876	—	—	3,876	3,876	—	267p		14/08/01	14/02/02
—	1,332 <sup>(d)</sup>	—	1,332	1,332	—	518p		14/08/03	14/02/04	
	<b>258,271</b>	<b>1,332</b>	<b>175,855</b>	<b>83,748</b>	<b>5,208</b>	<b>78,540<sup>(h)</sup></b>				
B Cockburn	—	3,330 <sup>(d)</sup>	—	3,330	—	<b>3,330<sup>(i)</sup></b>	518p	14/08/03	14/02/04	
Sir Alan Rudge <sup>(e)</sup>	10,940	—	10,940 <sup>(f)</sup>	—	—	—	430p	648p	04/03/96	04/03/03
	2,460	—	2,460 <sup>(f)</sup>	—	—	—	375p	648p	08/12/97	08/12/04
	2,254	—	1,193 <sup>(g)</sup>	—	—	—	306p	670.5p	14/06/00	14/12/00
	<b>15,654</b>	—	<b>14,593</b>	—	—	—				
<b>Total</b>	<b>362,872</b>	<b>4,662</b>	<b>190,448</b>	<b>176,025</b>	<b>5,208</b>	<b>170,817</b>				

*Notes:*

- (a) All of the above options were granted for nil consideration.
- (b) Options exercised under the BT Share Option Scheme on 12 October 1998.
- (c) Options exercised under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 15 July 1998.
- (d) Options granted under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 25 June 1998.
- (e) Dr Rudge retired as a director of the company on 31 October 1997.
- (f) Options exercised under the BT Share Option Scheme on 22 April 1998.
- (g) Options exercised under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 3 April 1998. Dr Rudge exercised a proportion of the shares under option in accordance with the rules of the Scheme, following which the remaining 1,061 shares under option lapsed.
- (h) Robert Brace's options will lapse on 31 December 2001, twelve months after he ceased to be employed by the Company.
- (i) Options under BT Employee Sharesave Scheme exercisable over a maximum of 1,921 shares for six months from 31 March 2001, the date on which Bill Cockburn ceased employment with the company.

It is a term of Sir Christopher Bland's service agreement that (i) he purchases, as soon as permitted under BT's share dealing code, BT shares to the value of at least £1 million; and (ii) as soon as practical after the purchase of the shares (the Invested Shares), the company will grant an option under the Share Options element of the Portfolio over shares to the value of £1 million. So long as Sir Christopher is the legal and beneficial owner of the Invested Shares on 1 May 2004, the options will become exercisable on that date.

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Unrealised gains on the above share options at 31 March 2001, based on the market price of the shares at that date, excluding the employee compensation for the special dividend which is discretionary in respect of directors' share options, were as shown below:

	Options exercisable				Options not exercisable			
	Number of shares	Unrealised gains			Number of shares	Unrealised gains		
		2001 £000	2000 <sup>(a)</sup> £000	1999 <sup>(b)</sup> £000		2001 £000	2000 <sup>(a)</sup> £000	1999 <sup>(b)</sup> £000
Sir Iain Vallance	82,487	125	673	538	—	—	—	—
Sir Peter Bonfield	—	—	—	—	6,460	16	59	48
B Cockburn	—	—	—	—	3,330	—	22	16
R P Brace	78,540	67	589	460	—	—	44	35

### Notes:

- (a) Based on options outstanding at 31 March 2000 and the market price of the shares at that date.  
(b) Based on options outstanding at 31 March 1999 and the market price of the shares at that date.

The market price of the shares at 31 March 2001 was 510p (2000 — 1,175p, 1999 — 1,011p) and the range during the 2001 financial year was 469p to 1,172p.

Details of the company's ordinary shares provisionally awarded to directors, as participants under the ESP and as awards of Incentive Shares and Retention Shares, are as follows:

	Total number of award shares <sup>(a)(b)</sup>				Range of value of award <sup>(c)(d)</sup>	
	1 April 1998	Awarded	Dividends reinvested	31 March 1999	Minimum £000	Maximum £000
Sir Peter Bonfield	240,420	71,909	6,511	318,840	499	3,223
R P Brace	256,909	36,508	6,106	299,523	478	3,028
B Cockburn	32,520	49,782	1,714	84,016	302	816
Sir Alan Rudge	124,028	—	2,582	126,610	256	1,280
<b>Total</b>	<b>653,877</b>	<b>158,199</b>	<b>16,913</b>	<b>828,989</b>	<b>1,535</b>	<b>8,347</b>

### Notes:

- (a) Excluding shares purchased by each director and held under the ESP.  
(b) During the 1998 financial year, Bill Cockburn was awarded 32,520 shares under the PSP. The three-year performance cycle for that award ended on 31 July 1998 and, on the basis of the position of BT's TSR at the end of the initial three-year cycle, 90 per cent. of the shares under award, including reinvested dividends, will vest. The vesting will take place within the two years following the end of the performance cycle in accordance with the rules of the plan.  
(c) For the ESP, based on the market value of the company's shares at 31 March 1999. The minimum figure represents those shares held at 31 March 1999 which will transfer to each director at the end of year five of the plan (1999 to 2003). The maximum figures represents all shares held at 31 March 1999 which will transfer to each director at the end of year five of the plan (1999 to 2003) provided the corporate performance measure has been fully met. Normally, shares will transfer only if the individual is still employed by the group. However, the plan gives discretion to preserve awards of shares in cessation.  
(d) For the PSP, shows the market value at 31 March 1999 of the company's shares which will vest in Bill Cockburn.

	Total number of award shares <sup>(a)</sup>					Range of value of award <sup>(d)</sup>	
	1 April 1999	Awarded	Vested	Dividends reinvested	31 March 2000	Minimum £000	Maximum £000
Sir Peter Bonfield	318,840	65,361	—	6,006	390,207	589	4,585
R P Brace <sup>(b)</sup>	299,523	32,004	65,724	4,151	269,954	408	3,172
B Cockburn <sup>(c)</sup>	84,016	44,625	29,878	1,492	96,935	—	1,139
Sir Alan Rudge <sup>(b)</sup>	126,610	—	78,874	744	48,480	114	570
<b>Total</b>	<b>828,989</b>	<b>141,990</b>	<b>174,476</b>	<b>12,393</b>	<b>805,576</b>	<b>1,111</b>	<b>9,466</b>

*Notes:*

- (a) Excluding shares purchased by each director and held under the ESP.
- (b) On 2 August 1999, total awards of 65,724 and 78,874 shares under the ESP vested in Robert Brace and Sir Alan Rudge, respectively. The five-year performance cycle for those awards ended on 31 July 1999 and, on the basis of BT's TSR position against the FT-SE 100, 100 per cent. of the shares under award, including reinvested dividends, vested. The value of those shares on the vesting date was £694,966 for Robert Brace and £834,014 for Sir Alan Rudge.
- (c) On 2 August 1999, an award of 29,878 shares under the PSP vested in Bill Cockburn. The three-year performance cycle for that award ended on 31 July 1998 and, on the basis of BT's TSR against the FT-SE 100 at the end of the three-year cycle, 90 per cent. of the shares under award, including reinvested dividends, vested. The remaining 3,320 shares under award lapsed. Under the rules of PSP, vesting of the awards must take place within the two years following the end of the performance cycle. The value of those shares on the vesting date was £315,930.
- (d) For the ESP based on the market value of the company's shares at 31 March 2000. The minimum figure represents those shares held at 31 March 2000 which will transfer to each director at the end of year five of the plan (2000 to 2004). The maximum figure represents all shares held at 31 March 2000 which will transfer to each director at the end of year five of the plan (2000 to 2004) provided the corporate performance measure has been fully met. Normally, shares will transfer only if the individual is still employed by the group. However, the plan gives discretion to preserve awards of shares after retirement.

	Total number of award shares <sup>(a)</sup>					Range of value of award <sup>(c)(d)</sup>		
	1 April 2000	Awarded	Vested	Lapsed	Dividends reinvested	31 March 2001	Minimum £000	Maximum £000
Sir Peter Bonfield	390,207	179,516	—	—	16,172	<b>585,895</b>	304	2,988
P R Hampton <sup>(d)</sup>	—	59,361	—	—	828	<b>60,189</b>	307	307
B Cockburn	96,935	—	—	—	2,657	<b>99,592</b>	—	508
R P Brace <sup>(b)</sup>	269,954	43,728	41,552	77,449	6,592	<b>201,273</b>	192	1,026
Sir Alan Rudge <sup>(b)</sup>	48,480	—	48,480	—	—	—	—	—
<b>Total</b>	<b>805,576</b>	<b>282,605</b>	<b>90,032</b>	<b>77,449</b>	<b>26,249</b>	<b>946,949</b>	<b>803</b>	<b>4,829</b>

*Notes:*

- (a) Excluding shares purchased by each director and held under the ESP.
- (b) On 1 August 2000, total awards of 41,552 and 48,480 shares under the ESP vested in Robert Brace and Sir Alan Rudge, respectively. The five-year performance cycle for those awards ended on 31 July 2000 and, on the basis of BT's TSR position against the FT-SE 100, 100 per cent. of the shares under award, including reinvested dividends, vested on 1 August 2000.
- (c) Based on the market value of the company's shares at 31 March 2001. The minimum figure represents those shares held at 31 March 2001 which will transfer to each director under the ESP at the end of year five of the plan (2001 to 2004) and at the end of year three for Incentive Shares (2003). The maximum figure represents all shares held at 31 March 2001 which will transfer to each director at the end of year five of the ESP (2001 to 2004) and at the end of year three for Incentive Shares (2003) provided the corporate performance measure has been fully met. Normally, shares will transfer only if the individual is still employed by the group. However, the plans give discretion to preserve awards of shares on cessation.
- (d) Philip Hampton was granted an award of Retention Shares over 59,361 shares, equivalent to 100 per cent. of salary. This award will vest, provided that he is still employed by the company, on 1 November 2003, the third anniversary of the date of the commencement of his employment with the company. The vesting of the shares is not subject to the satisfaction of a corporate performance target.
- (e) At the next grant to participants of awards of Incentive Shares, Sir Christopher Bland will be granted an award equal to twice salary. After the grant of that award of Incentive Shares, he will not be eligible to receive further awards of Incentive Shares, Retention Shares or grants of Share Options until 1 May 2004.

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Details of awards of shares under the ESP and awards of Incentive Shares which would vest based on BT's TSR compared with other companies in the FT-SE 100 for the relevant performance period up to 31 March 2001 are as follows:

	No. of shares under award	Expected vesting date	31 March 2001		31 March 2000		31 March 1999	
			TSR position	Percentage of shares vesting	TSR position	Percentage of shares vesting	TSR position	Percentage of shares vesting
Sir Peter Bonfield	125,210	2001	<b>28</b>	<b>100</b>	3	100	4	100
	105,964	2002	<b>34</b>	<b>90</b>	3	100	4	100
	76,603	2003	<b>38</b>	<b>80</b>	5	100	3	100
	184,974	2003	<b>91</b>	—	—	—	—	—
	68,205	2004	<b>86</b>	—	—	—	—	—
B Cockburn	53,028	2003	<b>38</b>	<b>80</b>	5	100	3	100
	46,564	2004	<b>86</b>	—	28	100	—	—
R P Brace	77,625	2001	<b>28</b>	<b>100</b>	3	100	4	100
	57,637	2002	<b>34</b>	<b>90</b>	3	100	4	100
	38,887	2003	<b>38</b>	<b>80</b>	5	100	3	100

The following deferred bonuses have been awarded to the directors under the DBP. These shares will normally be transferred to participants at the end of the three-year deferred period if those participants are still employed by BT.

	1 April 1999	Awarded	Dividends reinvested		Awarded	Dividends reinvested	31 March 2001	Market value		
			1 April 2000					2001 £000	2000 £000	1999 £000
Sir Peter Bonfield	18,352	103,677	1,909	123,938	57,537	4,857	<b>186,332</b>	<b>950</b>	1,456	186
B Cockburn	6,605	25,243	497	32,345	—	887	<b>33,232</b>	<b>169</b>	380	67
R P Brace	6,605	7,437	218	14,260	—	390	<b>14,650</b>	<b>75</b>	168	67

### 32. People employed

	2001		2000		1999	
	Year end '000	Average '000	Year end '000	Average '000	Year end '000	Average '000
Number of employees in the group:						
UK	<b>117.9</b>	<b>120.3</b>	126.0	123.8	118.9	119.8
Non-UK	<b>19.1</b>	<b>13.1</b>	10.8	8.3	5.8	5.1
<b>Total employees</b>	<b>137.0</b>	<b>133.4</b>	136.8	132.1	124.7	124.9

BT Group	115.3	118.3	125.4	122.4	116.9	118.7
Discontinued activities	21.7	15.1	11.4	9.7	7.8	6.2
<b>Total employees</b>	<b>137.0</b>	<b>133.4</b>	<b>136.8</b>	<b>132.1</b>	<b>124.7</b>	<b>124.9</b>

### 33. Employee share schemes

The company has a share ownership scheme used for employee share allocations (profit sharing), savings-related share option schemes for its employees and those of participating subsidiaries, further share option schemes for selected group employees and an employee stock purchase plan for employees in the United States. It also has several share plans for executives. The figures in this note have not been restated for the dilutive effect of the rights issue which closed on 15 June 2001.

#### Share option schemes

The major share option scheme, the BT Employee Sharesave Scheme, is savings related and the share options are normally exercisable on completion of a three- or five-year Save As You Earn contract. A similar savings related scheme exists for group employees based outside the UK. Under the other share option schemes, share options are normally exercisable between the third and tenth anniversaries of the date of grant. Under a new option scheme introduced in 2000, scheme participants are awarded options which may vest after three years and which may be linked to a performance target. Options outstanding under these share option schemes at 31 March 2000 and 2001, together with their exercise prices and dates, were as follows:

Normal dates of exercise	Option price per share	Number of ordinary shares	
		2001 millions	2000 millions
<b>Savings-related schemes</b>			
2000	404p	—	4
2000	306p	—	37
2001	267p	58	62
2001	583p	3	4
2002	359p	44	48
2002	949p	3	4
2003	518p	35	38
2003	818p	5	—
2004	844p	23	29
2005	727p	32	—
<b>Total</b>		<b>203</b>	<b>226</b>
<b>Global share options</b>			
2001-2010	885p	2	—
2002-2011	885p	3	—
2003-2012	885p	3	—
<b>Total</b>		<b>211</b>	<b>—</b>
<b>Other share option schemes</b>			
1993-2011	289p to 1206p	5	6
<b>Total options outstanding</b>		<b>216</b>	<b>232</b>

In the period 1 April 2001 to 22 May 2001, no share options were granted, and options over eleven million shares lapsed.

During the year ended 31 March 2001, BT granted options over 49 million shares (2000 — 34 million, 1999 — 46 million) of which 41 million were under employee sharesave schemes and eight million were under the BT Global Share Option Plan. The weighted average fair value of share options granted during the year ended 31 March 2001 has been estimated on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used in that model: an expected life extending one month later than the first exercise date; estimated annualised dividend yield of approximately 2 per cent. (2000 — 2 per cent., 1999 — 3 per cent.); risk free interest rates of approximately 7 per cent. (2000 — 6 per cent., 1999 — 7 per cent.) on options exercisable three years after the date of grant and 7 per cent. (2000 — 6 per cent., 1999 — 7 per cent.) on options exercisable five years after the date of grant; and expected volatility of approximately 41 per cent. (2000 — 40 per cent., 1999 — 30 per cent.).

The weighted average fair value of the share options granted in the year ended 31 March 2001 was 329p (2000 — 413p, 1999 — 313p) for options exercisable three years after the date of grant and 424p (2000 — 524p, 1999 — 309p) for options exercisable five years after the date of grant. The total value of share options granted by BT in the year ended 31 March 2001 was £168 million (2000 — £170 million, 1999 — £139 million). In accordance with UK accounting practices, no compensation expense

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is recognised for the fair value of options granted. See *United States Generally Accepted Accounting Principles — IV Accounting for share options* for the treatment under US GAAP.

Options granted, exercised and lapsed under these share option schemes during the years ended 31 March 1999, 2000 and 2001 and options exercisable at 31 March 1999, 2000 and 2001 were as follows:

	Savings related schemes millions	Other share option schemes millions	Total millions	Exercise price range	Weighted average exercise price
Outstanding, 31 March 1998	253	8	261	262p–596p	316p
Granted	45	1	46	518p–1053p	536p
Exercised	(46)	(3)	(49)	262p–583p	321p
Lapsed	(15)	—	(15)	265p–773p	328p
Outstanding, 31 March 1999	237	6	243	267p–1053p	356p
Granted	33	1	34	844p–1206p	862p
Exercised	(36)	(1)	(37)	267p–949p	333p
Lapsed	(8)	—	(8)	267p–1043p	366p
Outstanding, 31 March 2000	226	6	232	267p–1206p	432p
Granted	41	8	49	534p–885p	751p
Exercised	(46)	(1)	(47)	168p–1351p	319p
Lapsed	(17)	(1)	(18)	168p–1351p	619p
<b>Outstanding, 31 March 2001</b>	<b>204</b>	<b>12</b>	<b>216</b>	<b>168p–1351p</b>	<b>564p</b>
Exercisable, 31 March 1999	—	4	4	289p–460p	369p
Exercisable, 31 March 2000	—	3	3	289p–460p	368p
Exercisable, 31 March 2001	—	3	3	289p–460p	368p

### BT Incentive Share Plan and BT Retention Share Plan

The BT Incentive Share Plan (ISP) and the BT Retention Share Plan (RSP) were introduced for employees of the group in 2001. Under the plans, company shares are acquired by an employee share ownership trust and are conditionally awarded to participants. Under the ISP participants are normally only entitled to these shares in full at the end of a three-year period if the company has met the relevant pre-determined corporate performance measure and if the participants are still employed by the group. If the company has exceeded the pre-determined corporate performance measure the participants may be awarded up to double the shares conditionally awarded. Under the RSP the length of retention period before awards vest is flexible. Awards may vest in annual tranches. The shares are transferred at the end of a specified period, only if the individual is still employed by the group. The corporate performance measure assesses the company's overall performance against those top 100 companies listed on the London Stock Exchange, as rated by the *Financial Times* (the FT-SE 100 index), at the beginning of the relevant performance period.

### BT Executive Share Plan, BT Performance Share Plan and BT Deferred Bonus Plan

The BT Executive Share Plan (ESP) and the BT Performance Share Plan (PSP) were introduced for employees of the group in 1994 and 1995 respectively. Under the plans, company shares are acquired by an employee share ownership trust and are conditionally awarded to participants. Participants are only entitled to these shares in full at the end of a five-year period under the ESP and the end of a three-year period, under the PSP if, at the end of the applicable period, the company has met the relevant pre-determined corporate performance measure. Awards of shares were granted in each of the years from 1994 to 1999 under the ESP and from 1995 to 1997 under the first performance cycle of the PSP.

In 1994, 1995 and 1996 ESP participants could invest 50 per cent. of their annual bonus in the ESP for the purchase of shares. These invested shares were matched by the company.

Further awards of shares were granted in 1998 and 1999 under the second three-year performance cycle of the PSP. The corporate performance measure assesses the company's overall performance against those top 100 companies listed on the London Stock Exchange, as rated by the *Financial Times* (the FT-SE 100 index), at the beginning of the relevant performance period.

The second five-year performance cycle of the ESP ended on 31 July 2000 (first: 31 July 1999) and on the basis of the corporate measure, the company's Total Shareholder Return target relative to the other companies in the FT-SE 100, 100 per cent.



(1999: 100 per cent.) of the shares vested on 1 August 2000 in 54 participants (1999: 25 participants) and 0.7 million shares (1999: 0.6 million shares) were transferred to those participants.

The first three-year performance cycle of the PSP ended on 31 July 1998 and on the basis of the corporate measure, the company's Total Shareholder Return target relative to the other companies in the FT-SE 100, 90 per cent. of the shares vested on 19 August 1998 in 745 participants and 5.0 million shares were transferred to those participants.

The second and final three-year performance cycle of the PSP ended on 31 March 2001 and on the basis of the corporate measure, the company's Total Shareholder Return target relative to other companies in the FT-SE 100, 80 per cent. of the shares will vest on 1 August 2001 in 1,560 participants and 2.0 million shares will transfer to those participants.

The BT Deferred Bonus Plan (DBP) was established in 1998 and awards were granted to employees of the group in July 1998 and 1999. Under this plan, shares in the company are acquired by an employee share ownership trust and transferred to participants at the end of three years if he or she has continued to be employed by the group throughout that period.

At 31 March 2001, 19.1 million shares (2000 — 19.3 million) in the company were held in trust for employee share schemes, of which 9.7 million shares were held for the ISP, 0.4 million shares were held for the RSP, 5.4 million shares (2000 — 5.9 million) were held for the ESP, 2.0 million shares (2000 — 2.2 million) were held for the PSP and 1.6 million shares (2000 — 0.9 million) were held for the DBP. Dividends or dividend equivalents earned on the shares during the conditional periods are reinvested in company shares for the potential benefit of the participants. Additional information relating to the plans is as follows:

	Year ended 31 March 2001					
	ISP £m	RSP £m	ESP £m	PSP £m	DBP £m	Total £m
Value of range of possible future transfers: nil to	25.2	2.2	24.7	10.2	6.7	69.0
Provision for the costs of the plans charged to the profit and loss account in year	—	1.5	5.8	(1.7)	2.5	8.1
Nominal value of shares held in trust	2.4	0.1	1.4	0.5	0.4	4.8
Market value of shares held in trust	49.7	2.2	27.3	10.2	8.3	97.7
	Year ended 31 March 2000					
	ISP £m	RSP £m	ESP £m	PSP £m	DBP £m	Total £m
Value of range of possible future transfers: nil to	—	—	66.9	25.3	10.4	102.6
Provision for the costs of the plans charged to the profit and loss account in year	—	—	6.4	14.4	7.7	28.5
Nominal value of shares held in trust	—	—	1.5	0.6	0.2	2.3
Market value of shares held in trust	—	—	69.4	25.4	10.4	105.2

In addition, 10.3 million shares were held at 31 March 2000 in trust for future awards under employee share schemes. These shares had a nominal value of £2.6 million and a market value of £122 million at 31 March 2000.

The values of possible future transfers of shares under the plans were based on the company's share price at 31 March 2001 of 510p (2000 — 1,175p). The provisions for the costs of the ISP, RSP, ESP and PSP were based on best estimates of the company's performance over the plans' conditional periods, relating to those portions of the plan conditional periods from commencement up to the financial year end.

### BT Employee Stock Purchase Plan

An employee stock purchase plan was established in 1998 for employees in the United States. Under this plan, employees may purchase American Depositary Shares (ADSs) on a monthly basis at a price equal to the lower of (i) 85 per cent. of the average trading price of the ADSs on the New York Stock Exchange on the date on which the purchase rights are granted and, (ii) 85 per cent. of the average trading price of the ADSs on the date of purchase. During the year ended 31 March 2001, the discounted price was between US\$65.98 and US\$154.88 (2000 — US\$92.20 and US\$170.21) per ADS and 0.1 million shares (2000 — 0.8 million) were issued under this plan.

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### 34. Auditors

The auditors' remuneration for the year ended 31 March 2001 for the group was £3,639,000 (2000 — £2,650,000, 1999 — £2,491,000), including £1,261,000 (2000 — £1,229,000, 1999 — £1,216,000) for the company.

The following fees were paid or are payable to the company's auditors, PricewaterhouseCoopers, in the UK for the years ended 31 March 2001, 31 March 2000 and 31 March 1999:

	2001 £000	2000 £000	1999 £000
Audit of the company's statutory accounts	1,261	1,229	1,216
Audits of the UK subsidiary undertakings' statutory accounts	839	834	605
Other services <sup>(a)</sup> :			
Accountants' reports on restructuring/demerger projects	9,756	—	—
Regulatory, tax, accounting and other audit	2,717	2,617	3,030
Concert global venture related work	1,196	5,117	1,023
Systems advice	1,360	1,461	2,808
Corporate finance advice	730	1,810	596
Other consultancy	464	1,740	1,398
<b>Total</b>	<b>18,323</b>	<b>14,808</b>	<b>10,676</b>

#### Note:

(a) Fees for the year ended 31 March 1999 comprise work carried out by Coopers & Lybrand and Price Waterhouse in the three months to 30 June 1998 and work carried out by PricewaterhouseCoopers on or subsequent to 1 July 1998, the date of the firms' merger.

In addition, fees of £3,025,000 were paid or are payable to PricewaterhouseCoopers for the year ended 31 March 2001 (2000 — £6,382,000) in respect of audit and other services to the company's subsidiary undertakings outside the UK. Fees of £6,418,000 were paid to other international members of Coopers & Lybrand, Price Waterhouse or PricewaterhouseCoopers for the year ended 31 March 1999 in respect of audit and other services to the company's subsidiary undertakings outside the UK. Fees of £1,283,000 and £865,000 were paid for work carried out by Price Waterhouse inside and outside the UK, respectively, between 1 April and 1 July 1998.

### 35. Financial instruments and risk management

The group holds or issues financial instruments mainly to finance its operations; for the temporary investment of short-term funds; and to manage the currency and interest rate risks arising from its operations and from its sources of finance. In addition, various financial instruments — for example trade debtors and trade creditors — arise directly from the group's operations.

The group finances its operations primarily by a mixture of issued share capital, retained profits, long-term loans and, increasingly over the years ended 31 March 2000 and 2001, short-term loans, principally by issuing commercial paper and medium-term notes. The group borrows in the major long-term debt markets in major currencies and significant new long-term debt was taken on in the year ended 31 March 2001. Typically, but not exclusively, the bond markets provide the most cost-effective means of long-term borrowing. The group uses derivative financial instruments primarily to manage its exposure to market risks from changes in interest and foreign exchange rates. The derivatives used for this purpose are principally interest rate swaps, gilt locks, currency swaps and forward currency contracts.

The types of financial instrument used for investment of short-term funds are prescribed in group treasury policies with limits on the exposure to any one organisation. Short-term investing in financial instruments is undertaken on behalf of the group by external substantial fund managers who are limited to dealing in debt instruments and certain defined derivative instruments and are given strict guidelines on credit, diversification and maturity profiles.

During the year ended 31 March 2001, net debt increased from £8.7 billion to £27.9 billion mainly as a result of the group making acquisitions of businesses and third-generation mobile licences. This increase in debt has been funded primarily by the issuance of long-term debt together with use of the group's medium-term note programme. As a result of this, together with the group's interest rate swap activity, the borrowing profile has changed during the year from one mainly at floating rates to one with a fixed: floating rate ratio of approximately 70:30. This change is in line with the group's intention to limit the group's exposure to interest rate increases given the substantial size of the group's debt portfolio. During the second quarter of the year ended 31 March 2001, it was not practical for the group to issue longer-term debt in the global capital markets. The group therefore pre-

hedged its desired fixed rate profile by transacting £9.3 billion of interest rate swaps with maturities ranging from five to 30 years at a weighted average fixed interest payable rate of 6.2 per cent.

During the year ended 31 March 2000, net debt increased from £953 million to £8,700 million primarily as a result of the group making acquisitions of businesses and interests in joint ventures and associates. This increase in debt was primarily funded under the group's commercial paper programmes. As a result, the group's borrowing profile changed during that year from one at fixed rates to one mainly at floating rates.

The group uses financial instruments to hedge some of its currency exposures arising from its non-UK assets, liabilities and forward purchase commitments. The group also hedges some of its interest liabilities. The financial instruments used comprise borrowings in foreign currencies, forward foreign currency exchange contracts, gilt locks and interest and currency swaps.

There has been no change in the nature of the group's risk profile between 31 March 2001 and the date of these financial statements.

The risk profile of the group is likely to change following the completion of the rights issued announced on 10 May 2001, and the proceeds due to be received on the planned disposals of the investments in Japan and elsewhere which have been announced to date (see note 29). In May 2001, Moody's downgraded BT's credit rating to Baa1, which will increase BT's annual interest charge by £32 million.

The notional amounts of derivatives summarised below do not necessarily represent amounts exchanged by the parties and, thus, are not necessarily a measure of the exposure of the group through its use of derivatives. The amounts exchanged are calculated on the notional amounts and other terms of the derivatives which relate to interest and exchange rates.

#### **(a) Interest rate risk management**

The group has entered into interest rate swap agreements with banks and other institutions to vary the amounts and periods for which interest rates on borrowings are fixed. Under interest rate swaps, the group agrees with other parties to exchange, at specified intervals, the differences between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. Under gilt locks, forward sales of UK government long-dated treasury stock were entered into for periods of up to one year. This hedge effectively fixed in the interest on part of the group's then future borrowings, all of which have now been taken on.

At 31 March 2001, the group had outstanding interest rate swap agreements having a total notional principal amount of £9,574 million (2000 — £2,073 million, including gilt locks).

#### **(b) Foreign exchange risk management**

Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investments, interest expense and purchase and sale commitments denominated in foreign currencies (principally US dollars, the euro and the yen). The remaining terms of the currency swaps are up to 30 years and the terms of currency forward exchange contracts are typically less than one year. The purpose of the group's foreign currency hedging activities is to protect the group from the risk that the eventual net inflows and net outflows will be adversely affected by changes in exchange rates.

At 31 March 2001, the group had outstanding foreign currency swap agreements and forward exchange contracts having a total notional principal amount of £25,325 million (2000 — £11,948 million).

The fair values of forward foreign currency contracts at 31 March 2001 were £4,388 million (2000 — £7,088 million) for purchases of currency and £601 million (2000 — £1,852 million) for sales of currency. These fair values have been estimated by calculating their present values using the market discount rates, appropriate to the terms of the contracts, in effect at the balance sheet dates.

At 31 March 2001, the group had deferred unrealised gains of £13 million (2000 — £18 million) and losses of £34 million (2000 — £43 million), based on dealer-quoted prices, from hedging purchase and sale commitments, and in addition had deferred realised net gains of £25 million (2000 — £11 million). These are included in the profit and loss account as part of the hedged purchase or sale transaction when it is recognised, or as gains or losses when a hedged transaction is no longer expected to occur.

## Part 5: Financial information on BT and BT Group

### (c) Concentrations of credit risk and credit exposures of financial instruments

The group considers that it is not exposed to major concentrations of credit risk. The group, however, is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not expect any counterparties to fail to meet their obligations. The group limits the amount of credit exposure to any one counterparty. The group does not normally see the need to seek collateral or other security.

The long-term debt instruments issued in December 2000 and February 2001 both contain covenants that if the group credit rating is downgraded below A3 in the case of Moody's or below A minus in the case of S&P, additional interest accrues from the next interest coupon period at the rate of 0.25 percentage points for each ratings category adjustment by each ratings agency. Based upon the total amount of debt of £12,930 million outstanding on these instruments at 31 March 2001, the group's annual interest charge would increase by £65 million if the group's credit rating was to fall by one credit rating category below a long-term debt rating of A3/A minus.

### (d) Fair value of financial instruments

The following table shows the carrying amounts and fair values of the group's financial instruments at 31 March 2001 and 2000. The carrying amounts are included in the group balance sheet under the indicated headings, with the exception of derivative amounts, which are included in debtors or other creditors or as part of net debt as appropriate. The fair values of the financial instruments are the amount at which the instruments could be exchanged in a current transaction between willing parties, other than in forced or liquidation sale.

	Carrying amount		Fair value	
	2001 £m	2000 £m	2001 £m	2000 £m
Non-derivatives:				
Assets				
Cash at bank and in hand	412	253	412	253
Short-term investments <sup>(a)</sup>	2,557	2,051	2,562	2,052
Fixed asset investments – loans to joint ventures <sup>(b)</sup>	737	1,073	737	1,073
Liabilities				
Short-term borrowings <sup>(c)</sup>	10,220	5,121	10,219	5,121
Long-term borrowings, excluding finance leases <sup>(d)</sup>	20,592	5,874	20,852	6,085
Derivatives relating to investments and borrowings (net) <sup>(e)</sup> :				
Assets				
	259	44	—	—
Liabilities				
	—	—	350	100
Derivative financial instruments held or issued to hedge the current exposure on expected future transactions (net):				
Assets				
	—	—	—	—
Liabilities				
	—	—	21	25

#### Notes:

- The fair value of listed short-term investments were estimated based on quoted market prices for those investments. The carrying amount of the other short-term deposits and investments approximated to their fair values due to the short maturity of the instruments held.
- The fair value of loans to joint ventures approximated to carrying value due to loans bearing commercial rates of interest.
- The fair value of short-term borrowings approximated to carrying value due to the short maturity of the instruments.
- The fair value of the group's bonds, debentures, notes and other long-term borrowings has been estimated on the basis of quoted market prices for the same or similar issues with the same maturities where they existed, and on calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates, where market prices of similar issues did not exist.
- The fair value of the group's outstanding foreign currency and interest rate swap agreements was estimated by calculating the present value, using appropriate discount rates in effect at the balance sheet dates, of affected future cash flows translated, where appropriate, into pounds sterling at the market rates in effect at the balance sheet dates. The following information is provided in accordance with the requirements of

FRS 13 — "Derivatives and other financial instruments: disclosures". Except for disclosures under *currency exposures* below, the financial information excludes all of the group's short-term debtors and creditors.

## Financial liabilities

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group's financial liabilities at 31 March was:

	2001				2000			
	Fixed rate financial liabilities £m	Floating rate financial liabilities £m	Financial liabilities on which no interest is paid £m	Total £m	Fixed rate financial liabilities £m	Floating rate financial liabilities £m	Financial liabilities on which no interest is paid £m	Total £m
Currency:								
Sterling	13,501	10,528	357	24,386	2,429	6,686	376	9,491
US dollar	806	145	293	1,244	353	83	7	443
Euro	4,759	664	72	5,495	424	389	30	843
Yen	508	–	–	508	508	–	1	509
Other	–	–	–	–	–	111	4	115
<b>Total</b>	<b>19,574</b>	<b>11,337</b>	<b>722</b>	<b>31,633</b>	<b>3,714</b>	<b>7,269</b>	<b>418</b>	<b>11,401</b>

For the fixed rate financial liabilities, the average interest rates and the average periods for which the rates are fixed are:

	2001		2000	
	Weighted average interest rate %	Weighted average period for which rate is fixed Years	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Currency:				
Sterling	7.5	16	9.1	15
US dollar	8.5	7	8.7	8
Euro	6.3	6	5.8	8
Yen	1.2	4	1.2	4
<b>Total</b>	<b>7.1</b>	<b>13</b>	<b>7.6</b>	<b>12</b>

The floating rate financial liabilities bear interest at rates fixed in advance for periods ranging from one day to one year by reference to LIBOR. The financial liabilities on which no interest is paid are due to mature within one year of the balance sheet date.

The maturity profile of financial liabilities is as given in note 23.

## Part 5: Financial information on BT and BT Group

### Financial assets

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group's financial assets at 31 March was:

	2001				2000			
	Fixed rate financial assets £m	Floating rate financial assets £m	Financial assets on which no interest is paid £m	Total £m	Fixed rate financial assets £m	Floating rate financial assets £m	Financial assets on which no interest is paid £m	Total £m
Currency:								
Sterling	56	2,935	306	3,297	395	2,869	265	3,529
US dollar	—	293	—	293	—	31	—	31
Euro	19	315	—	334	—	53	—	53
Other	—	27	—	27	—	29	—	29
<b>Total</b>	<b>75</b>	<b>3,570</b>	<b>306</b>	<b>3,951</b>	<b>395</b>	<b>2,982</b>	<b>265</b>	<b>3,642</b>

The sterling fixed rate financial assets yield interest at a weighted average of 6.3 per cent. (2000 — 6.6 per cent.) for a weighted average period of 30 months (2000 — 18 months).

The floating rate financial assets bear interest at rates fixed in advance for periods up to one year by reference to LIBOR.

### Currency exposures

The table below shows the currency exposures of the group's net monetary assets (liabilities), in terms of those transactional exposures that give rise to net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the group that are not denominated in the operating (or "functional") currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in non-UK operations.

At 31 March, these exposures were as follows:

	2001					2000				
	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m	Sterling £m	US dollar £m	Euro £m	Other £m	Total £m
Functional currency of group operation:										
Sterling	—	3	3	2	8	—	13	117	29	159
Euro	1	(21)	—	(5)	(25)	6	(1)	—	—	5
Other	—	2	—	—	2	(10)	—	—	—	(10)
<b>Total</b>	<b>1</b>	<b>(16)</b>	<b>3</b>	<b>(3)</b>	<b>(15)</b>	<b>(4)</b>	<b>12</b>	<b>117</b>	<b>29</b>	<b>154</b>

The amounts shown in the table above take into account the effect of any currency swaps, forward contracts and other derivatives entered into to manage those currency exposures.

At 31 March 2001, the group also held various forward currency contracts that the group had taken out to hedge expected future foreign currency purchases and sales.

### Fair values of financial assets held for trading

	2001 £m	2000 £m
Net gain included in profit and loss account	62	51
Fair value of financial assets held for trading at 31 March	530	980

The net gain was derived from government bonds, commercial paper and similar debt instruments. The average fair value of financial assets held during the year ended 31 March 2001 did not differ materially from the year end position.

## Hedges

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised and deferred gains and losses on instruments used for hedging and those recognised in the years ended 31 March 2001 and 31 March 2000 are as follows:

	2001		2000	
	Gains £m	Losses £m	Gains £m	Losses £m
Gains and losses:				
recognised in the year but arising in previous years <sup>(a)</sup>	35	31	51	23
unrecognised at the balance sheet date	323	952	23	193
carried forward in the year end balance sheet, pending recognition in the profit and loss account <sup>(a)</sup>	106	36	99	15
expected to be recognised in the following year:				
unrecognised at balance sheet date	73	96	11	19
carried forward in the year end balance sheet pending, recognition in the profit and loss account <sup>(a)</sup>	27	7	24	12

Note:

(a) Excluding gains and losses on hedges accounted for by adjusting the carrying amount of a fixed asset.

## Average effective interest rates

The interest basis of interest rate swap agreements used, the notional amounts, their average maturities and weighted average interest rates are shown below:

	Average maturity	Notional amount £m	Average interest receivable rate %	Average interest payable rate %
Pay fixed interest and receive variable interest	Over 5 years	8,674	5.3	6.5
Pay variable interest and receive fixed interest	Under 5 years	900	6.5	5.5

The rates of the variable rate portion of the swaps are based on quoted rates. In calculating the average variable rates, the latest rates agreed with the counterparty on each swap have been used. Changes in interest rates will affect the variable rate information disclosed above.

## Unused committed lines of credit

Unused committed lines of credit for short-term financing available at 31 March 2001 totalled approximately £16,750 million (2000 — £5,800 million), which was in support of a commercial paper programme or other borrowings. These lines of credit are available for up to one year.

## Part 5: Financial information on BT and BT Group

### United States generally accepted Accounting Principles

The group's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the UK (UK GAAP), which differ in certain respects from those applicable in the US (US GAAP).

#### I Differences between United Kingdom and United States generally accepted accounting principles

The following are the main differences between UK and US GAAP which are relevant to the group's financial statements.

##### (a) Pension costs

Under UK GAAP, pension costs are accounted for in accordance with UK Statement of Standard Accounting Practice No. 24, costs being charged against profits over employees' working lives. Under US GAAP, pension costs are determined in accordance with the requirements of US Statements of Financial Accounting Standards (SFAS) Nos. 87 and 88. Differences between the UK and US GAAP figures arise from the requirement to use different actuarial methods and assumptions and a different method of amortising surpluses or deficits.

##### (b) Accounting for redundancies

Under UK GAAP, the cost of providing incremental pension benefits in respect of workforce reductions is taken into account when determining current and future pension costs, unless the most recent actuarial valuation, combined with the provision for pension costs in the group balance sheet, under UK actuarial conventions shows a deficit. In this case, the cost of providing incremental pension benefits is included in redundancy charges in the year in which the employees agree to leave the group.

Under US GAAP, the associated costs of providing incremental pension benefits are charged against profits in the period in which the termination terms are agreed with the employees.

##### (c) Capitalisation of interest

Under UK GAAP, the group does not capitalise interest in its financial statements. To comply with US GAAP, the estimated amount of interest incurred whilst constructing major capital projects is included in fixed assets, and depreciated over the lives of the related assets. This includes capitalisation of interest incurred on funding the UMTS licences for the period up to the launch of the related services. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. At 31 March 2001 under US GAAP, gross capitalised interest of £692 million (2000 — £349 million) with regard to the company and its subsidiary companies was subject to depreciation generally over periods of three to 25 years.

##### (d) Goodwill

Under UK GAAP, in respect of acquisitions completed prior to 1 April 1998, the group wrote off goodwill arising from the purchase of subsidiary undertakings, associates and joint ventures on acquisition against retained earnings. The goodwill is reflected in the net income of the period of disposal, as part of the calculation of the gain or loss on divestment. Under US GAAP, such goodwill is held as an intangible asset in the balance sheet and amortised over its useful life and only the unamortised portion is included in the gain or loss recognised at the time of divestment. Gross goodwill under US GAAP at 31 March 2001 of £10,309 million (2000 – £7,978 million) was subject to amortisation over periods of three to 20 years. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred. When impairment indicators exist, goodwill impairment is measured by discounting future projected cashflows or using quoted market prices if available.

##### (e) Mobile cellular telephone licences, software and other intangible assets

Certain intangible fixed assets recognised under US GAAP purchase accounting requirements are subsumed within goodwill under UK GAAP. Under US GAAP these separately identified intangible assets are valued and amortised over their useful lives.

##### (f) Financial instruments

Under UK GAAP, investments are held on the balance sheet at historical cost, and own shares held in trust for share schemes are recorded in fixed asset investments. Gains and losses on instruments used for hedges are not recognised until the exposure being hedged is recognised. Under US GAAP, trading securities and available-for-sale securities are carried at market value with appropriate valuation adjustments recorded in profit and loss and shareholders' equity, respectively. Certain derivative financial instruments which qualify as hedge accounting under UK GAAP do not qualify for hedge accounting under US GAAP.



These financial instruments, under US GAAP, are carried at market value with valuation adjustments recorded in profit and loss. Own shares held in trust are treated as a reduction to shareholders' equity until they are reissued to employees. The reassessment and purchase of derivatives in the year ended 31 March 2001 gave rise to an adjustment reducing net income by £93 million (2000 — £95 million). The net unrealised holding gain on available-for-sale securities for the year ended 31 March 2001 was £8 million (2000 — £311 million, 1999 — £76 million).

**(g) Deferred gain**

Under UK GAAP, assets contributed to a joint venture by the group's partners are measured at their net replacement cost. Any difference between the group's share of the joint venture's resulting net assets and the net book value of assets contributed by the group to the joint venture, including certain accrued start up costs, is immediately reflected by adjusting the group's investment in the joint venture and recording a deferred difference in shareholders' equity. Under US GAAP, the assets contributed by all joint venture partners are carried at their historical net book value and any difference between the group's share of the joint venture's resulting net assets and the net book value of assets contributed by the group to the joint venture is amortised over the life of the items giving rise to the difference.

**(h) Employee share plans**

Certain share options have been granted under BT save-as-you-earn plans at a 20 per cent. discount. Under UK GAAP, the share issues are recorded at their discounted price when the options are exercised. Under US GAAP, a plan is considered compensatory when the discount to market price is in excess of 15 per cent. Compensation cost is recognised for the difference between the exercise price of the share options granted and the quoted market price of the shares at the date of grant or measurement date and accrued over the vesting period of the options.

**(i) Directories in progress**

Under UK GAAP, the cost of classified advertising directories in progress deferred in stock represents direct fixed and variable costs as well as directly attributable overhead costs. Under US GAAP, the deferred costs associated with directories in progress comprise only the incremental direct costs associated with selling and creating the directories. Directories in progress acquired in a business purchase are valued at replacement value under UK GAAP and at retail value under US GAAP. Under UK GAAP, this difference is included in goodwill.

**(j) Revenue recognition**

During the year ended 31 March 2001 the group adopted Securities and Exchange Commission Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements". The adoption did not have a material impact on the results of operations or financial condition.

**(k) Investments in associates**

Under UK GAAP, the group records the share of operating profit and loss of ventures based upon the total interest in the venture based upon the consolidation structure. The group records the equity in the operations of the venture on the basis of its consolidated results excluding the holdings of any of the group's other ventures for the purpose of determining the economic interest. The share of the operations of the ventures is reduced to the economic interest through an increase to minority interests at the group level. Under US GAAP, the share of the operating results of the venture is recorded at the amount of the group's economic interest.

**(l) Deferred taxation**

Under UK GAAP, provision for deferred taxation is generally only made for timing differences which are expected to reverse. Under US GAAP, deferred taxation is provided on a full liability basis on all temporary differences as defined in SFAS No. 109.

At 31 March 2001, the adjustment of £1,296 million (2000 — £1,377 million) reconciling ordinary shareholders' equity under UK GAAP to the amount under US GAAP included the tax effect of other US GAAP adjustments. This comprised an adjustment increasing non-current assets by £26 million (2000 — £25 million increase); an adjustment increasing current assets by £92 million (2000 — £63 million increase,); an adjustment decreasing minority interests by £14 million (2000 — £35 million decrease) and an adjustment increasing long-term liabilities by £1,428 million (2000 — £1,500 million increase).

## Part 5: Financial information on BT and BT Group

### (m) Dividends

Under UK GAAP, dividends are recorded in the year in respect of which they are declared (in the case of interim or any special dividends) or proposed by the board of directors to the shareholders (in the case of final dividends). Under US GAAP, dividends are recorded in the period in which dividends are declared.

### II Net income and shareholders' equity reconciliation statements

The following statements summarise the material estimated adjustments, gross of their tax effect, which reconcile net income and shareholders' equity from that reported under UK GAAP to that which would have been reported had US GAAP been applied.

#### Net income

Years ended 31 March	2001 £m	2000 £m	1999 £m
Net income (loss) applicable to shareholders under UK GAAP	<b>(1,810)</b>	2,055	2,983
Adjustment for:			
Pension costs	<b>(42)</b>	(209)	(104)
Redundancy charges	<b>(453)</b>	(300)	(284)
Capitalisation of interest, net of related depreciation <sup>(a)</sup>	<b>348</b>	(14)	(19)
Goodwill amortisation <sup>(a)</sup>	<b>(55)</b>	(64)	85
Mobile licences, software and other intangible asset capitalisation and amortisation, net <sup>(a)</sup>	<b>(32)</b>	(33)	(226)
Financial instruments	<b>(133)</b>	(129)	(6)
Deferred gain	<b>(71)</b>	(19)	—
Employee share plans	<b>(38)</b>	—	—
Deferred taxation <sup>(a)</sup>	<b>11</b>	106	220
Directories in progress	<b>(82)</b>	—	—
Other items <sup>(a)</sup>	<b>—</b>	—	(60)
Net income (loss) as adjusted for US GAAP	<b>(2,357)</b>	1,393	2,589
Basic earnings (loss) per American Depositary Share as adjusted for US GAAP <sup>(b)</sup>	<b>£(3.23)</b>	£1.93	£3.61
Diluted earnings (loss) per American Depositary Share as adjusted for US GAAP <sup>(b)</sup>	<b>£(3.23)</b>	£1.88	£3.52

#### Notes:

- (a) The disposal of the group's interest in MCI shares during the year ended 31 March 1999 gave rise to adjustments; increasing net income by £163 million relating to goodwill and £95 million relating to deferred taxation and decreasing net income by £197 million relating to software and other intangible assets, £60 million relating to foreign exchange translation differences and £5 million relating to the capitalisation of interest.
- (b) Each American Depositary Share is equivalent to 10 ordinary shares of 25p each. Figures have been restated for the rights issue which closed on 15 June 2001.

#### Shareholders' equity

At 31 March	2001 £m	2000 £m
Shareholders' equity under UK GAAP	<b>14,069</b>	15,795
Adjustment for:		
Pension costs	<b>(2,755)</b>	(2,202)
Redundancy costs	<b>(25)</b>	(83)
Capitalisation of interest, net of related depreciation	<b>620</b>	261
Goodwill, net of accumulated amortisation	<b>122</b>	175
Mobile licences, software and other intangible asset capitalisation and amortisation	<b>521</b>	533
Financial instruments	<b>(620)</b>	(99)
Deferred gain	<b>(323)</b>	(230)
Deferred taxation	<b>(1,296)</b>	(1,377)
Directories in progress	<b>(82)</b>	—
Dividend declared after the financial year end	<b>—</b>	861
Shareholders' equity as adjusted for US GAAP	<b>10,231</b>	13,634

### III Minority interests

Under US GAAP, the loss to minority interests would have been reduced by £122 million (2000 — loss increased by £10 million, 1999 — income reduced by £12 million) after adjusting for goodwill amortisation and accounting for associates and joint ventures. Net assets attributable to minority interests would have been £32 million higher (2000 — £82 million higher) after adjusting for financial instruments.

#### IV Accounting for share options

Under UK GAAP, the company does not recognise compensation expense for the fair value, at the date of grant, of share options granted under the employee share option schemes. Under US GAAP, the company adopted the disclosure-only option in SFAS No. 123 “Accounting for Stock-Based Compensation”. Accordingly, the company accounts for share options in accordance with APB Opinion No. 25 “Accounting for Stock Issued to Employees”, under which no compensation expense is recognised. Had the group expensed compensation cost for options granted in accordance with SFAS No. 123, the group’s pro forma net income (loss), basic earnings (loss) per share and diluted earnings (loss) per share under US GAAP would have been £(2,419) million loss (2000 — £1,347 million profit, 1999 — £2,560 million profit), (33.2)p loss (2000 — 18.6p, 1999 — 35.6p) and (33.2)p loss (2000 — 18.2p, 1999 — 34.8p), respectively. The SFAS No. 123 method of accounting does not apply to share options granted before 1 January 1995, and accordingly, the resulting pro forma compensation costs may not be representative of that to be expected in future years. See note 33 for the SFAS No. 123 disclosures of the fair value of options granted under employee schemes at date of grant. Figures in this note have been restated for the dilutive effect of the rights issue which closed on 15 June 2001.

#### V Consolidated statements of cash flows

Under UK GAAP, the Consolidated Statements of Cash Flows are presented in accordance with UK Financial Reporting Standard No. 1 (FRS 1). The statements prepared under FRS 1 present substantially the same information as that required under SFAS No. 95.

Under SFAS No. 95 cash and cash equivalents include cash and short-term investments with original maturities of three months or less. Under FRS 1 cash comprises cash in hand and at bank and overnight deposits, net of bank overdrafts.

Under FRS 1, cash flows are presented for operating activities; returns on investments and servicing of finance; taxation; capital expenditure and financial investments; acquisitions and disposals; dividends paid to the company’s shareholders; management of liquid resources and financing. SFAS No. 95 requires a classification of cash flows as resulting from operating, investing and financing activities.

Cash flows under FRS 1 in respect of interest received, interest paid (net of that capitalised under US GAAP) and taxation would be included within operating activities under SFAS No. 95. Cash flows from purchases, sales and maturities of trading securities, while not separately identified under UK GAAP, would be included within operating activities under US GAAP. Capitalised interest, while not recognised under UK GAAP, would be included in investing activities under US GAAP. Dividends paid would be included within financing activities under US GAAP.

The following statements summarise the statements of cash flows as if they had been presented in accordance with US GAAP, and include the adjustments which reconcile cash and cash equivalents under US GAAP to cash at bank and in hand reported under UK GAAP.

	2001 £m	2000 £m	1999 £m
Net cash provided by operating activities	5,515	4,003	3,876
Net cash used in investing activities	(22,785)	(9,104)	(950)
Net cash provided by (used in) financing activities	18,311	4,697	(1,665)
Net increase (decrease) in cash and cash equivalents	1,041	(404)	1,261
Effect of exchange rate changes on cash	(15)	(1)	33
Cash and cash equivalents under US GAAP at beginning of year	1,255	1,660	366
Cash and cash equivalents under US GAAP at end of year	2,281	1,255	1,660
Short-term investments with original maturities of less than three months	(1,869)	(1,002)	(1,558)
Cash at bank and in hand under UK GAAP at end of year	412	253	102

#### VI Current asset investments

Under US GAAP, investments in debt securities would be classified as either trading, available-for-sale or held-to-maturity. Trading investments would be stated at fair values and the unrealised gains and losses would be included in income. Securities classified as available-for-sale would be stated at fair values, with unrealised gains and losses, net of deferred taxes, reported in shareholders’ equity. Debt securities classified as held-to-maturity would be stated at amortised cost. The following analyses do not include securities with original maturities of less than three months.

## Part 5: Financial information on BT and BT Group

At 31 March 2001, the group held trading investments (as defined by US GAAP) at a carrying amount of £390 million (2000 — £866 million, 1999 — £1,678 million) with fair values totalling £394 million (2000 — £873 million). Held-to-maturity securities at 31 March 2000 and 2001 consisted of the following:

	Amortised cost £m	Estimated fair value £m
UK Government securities and other UK listed investments	8	8
Commercial paper, medium-term notes and other investments	30	30
<b>Total at 31 March 2001</b>	<b>38</b>	<b>38</b>
UK Government securities and other UK listed investments	15	15
Commercial paper, medium-term notes and other investments	168	168
<b>Total at 31 March 2000</b>	<b>183</b>	<b>183</b>

The contractual maturities of the held-to-maturity debt securities at 31 March 2001 were as follows:

	Cost £m	Fair value £m
Maturing on or before 31 March 2002	38	38
Maturing after 31 March 2002	—	—
<b>Total at 31 March 2001</b>	<b>38</b>	<b>38</b>

### VII Pension costs

The following position for the main pension scheme is computed in accordance with US GAAP pension accounting rules under SFAS No. 87 and SFAS No. 88, the effect of which is shown in the above reconciliation statements.

The pension cost determined under SFAS No. 87 was calculated by reference to an expected long-term rate of return on scheme assets of 6.25 per cent. (2000 — 6.5 per cent., 1999 — 7.7 per cent.). The components of the pension cost for the main pension scheme comprised:

	2001 £m	2000 £m	1999 £m
Service cost	580	498	387
Interest cost	1,673	1,459	1,653
Expected return on scheme assets	(1,850)	(1,600)	(1,712)
Amortisation of prior service costs	24	24	24
Amortisation of net obligation at date of limited application of SFAS No. 87	52	52	52
Recognised gains	(133)	(65)	(137)
Additional cost of termination benefits	349	263	279
<b>Pension cost for the year under US GAAP</b>	<b>695</b>	<b>631</b>	<b>546</b>

The information required to be disclosed in accordance with SFAS No. 132 concerning the funded status of the main scheme at 31 March 2000 and 31 March 2001, based on the valuations at 1 January 2000 and 1 January 2001, respectively, is given below.

	2001 £m	2000 £m
<b>Changes in benefit obligation</b>		
Benefit obligation at the beginning of the year	31,024	27,158
Service cost	580	498
Interest cost	1,673	1,459
Employees' contributions	183	171
Additional cost of termination benefits	349	263
Actuarial movement <sup>(a)</sup>	(1,342)	2,992
Other changes	31	21
Benefits paid or payable	(1,314)	(1,538)
<b>Benefit obligation at the end of the year</b>	<b>31,184</b>	<b>31,024</b>
	2001 £m	2000 £m
<b>Changes in scheme assets</b>		
Fair value of scheme assets at the beginning of the year	29,876	25,120
Actual return on scheme assets	(350)	5,619
Employers' contributions <sup>(b)</sup>	605	483
Employees' contributions	183	171
Other changes	31	21
Benefits paid or payable	(1,314)	(1,538)
<b>Fair value of scheme assets at the end of the year</b>	<b>29,031</b>	<b>29,876</b>
	2001 £m	2000 £m
<b>Funded status under US GAAP</b>		
Projected benefit obligation in excess of scheme assets	(2,153)	(1,148)
Unrecognised net obligation at date of initial application of SFAS No. 87 <sup>(c)</sup>	106	158
Unrecognised prior service costs <sup>(d)</sup>	151	175
Other unrecognised net actuarial gains	(1,181)	(2,001)
<b>Accrued pension costs under US GAAP</b>	<b>(3,077)</b>	<b>(2,816)</b>

*Notes:*

- (a) In the year ended 31 March 2000, the actuarial movement is significant mainly due to revised mortality assumptions being employed in the year.
- (b) The employers' contributions for the year ended 31 March 2001 includes special contributions of £200 million paid on 21 December 2000 and £100 million paid on 30 March 2001 (2000 — £230 million, paid 31 March 2000).
- (c) The unrecognised net obligation at the date of initial application is being amortised over 15 years from 1 April 1988.
- (d) Unrecognised prior service costs on scheme benefit improvements, are being amortised over periods of 15 or 16 years commencing in the years of the introduction of the improvements.

The benefit obligation for the main pension scheme was determined using the following assumptions at 1 January 2000 and 1 January 2001:

	2001 per annum %	2000 per annum %
Discount rate	5.7	5.5
Rate of future pay increases	4.8	4.8

The determination also took into account requirements in the scheme as to future pension increases.

## Part 5: Financial information on BT and BT Group

### Subsidiary Undertakings, Joint Ventures and Associates

British Telecommunications plc is the parent company of the group. Brief details of its principal operating subsidiary undertakings, joint ventures and associates at 31 March 2001, all of which were unlisted unless otherwise stated, were as follows:

	Activity	Group interest in allotted capital <sup>(b)</sup>		Country of operations <sup>(c)</sup>
		2000	2001	
<b>Subsidiary undertakings</b>				
BT Australasia Pty Limited <sup>(d)</sup>	Communication related services and products provider	100% ordinary	100% ordinary	Australia
		100% preference	100% preference	
BT Cableships Limited <sup>(d)</sup>	Cableship owner	100% ordinary	100% ordinary	International
BT Cellnet Limited <sup>(d)(e)</sup>	Mobile cellular telephone system provider and operator	100% ordinary	100% ordinary	UK
BT Communications Management Limited <sup>(d)</sup>	Telecommunication services provider	100% ordinary	100% ordinary	UK
BT (Hong Kong) Limited <sup>(d)</sup>	Communication related services and products provider	100% ordinary	100% ordinary	Hong Kong
		100% preference	100% preference	
BT Ignite GmbH <sup>(d)</sup>	Data services provider	n/a	100% ordinary	Germany
BT Ignite GmbH & Co <sup>(d)</sup>	Communication related services and products provider	n/a	100% ordinary	Germany
BT Ignite Nederland BV <sup>(d)</sup>	Communication related services and products provider	n/a	100% ordinary	Netherlands
BT North America Inc <sup>(d)</sup>	Communication related services and products provider	100% common	100% common	USA
BT Property Limited <sup>(d)</sup>	Property holding company	100% ordinary	100% ordinary	UK
BT Subsea Cables Limited	Cable maintenance and repair	100% ordinary	100% ordinary	UK
BT Telecomunicaciones SA <sup>(d)</sup>	Communication related services and products provider	100% ordinary	100% ordinary	Spain
BT (Worldwide) Limited <sup>(d)</sup>	International telecommunication network systems provider	100% ordinary	100% ordinary	International
O <sub>2</sub> Limited <sup>(f)</sup>	Holding company for the BT Cellnet group	100% ordinary	100% ordinary	UK
Clear Communications Limited <sup>(d)</sup>	Communication related services and products provider	100% ordinary	100% ordinary	New Zealand
Esat Digifone Limited <sup>(d)(g)</sup>	Mobile cellular telephone system provider and operator	50.5% ordinary	50.5% ordinary	Ireland
Esat Group Limited <sup>(d)</sup>	Telecommunication services provider	100% ordinary	100% ordinary	Ireland
Farland BV <sup>(c)(d)</sup>	Provider of trans-border fibre network across BT's partners in Europe	100% ordinary	100% ordinary	International
Lumina Limited <sup>(d)(i)</sup>	Cellular telecommunication services provider	100% ordinary	100% ordinary	UK
Manx Telecom Limited <sup>(d)</sup>	Telecommunication services supplier	100% ordinary	100% ordinary	Isle of Man
Syntegra Groep BV <sup>(d)</sup>	Systems integration and application development	100% common	100% common	Netherlands
Syntegra SA <sup>(d)</sup>	Systems integration and application development	100% ordinary	100% ordinary	France
Syntegra (USA) Inc <sup>(c)(d)(h)</sup>	Systems integration and electronic business outsourcing services	100% ordinary	100% common	International
Telfort Mobiel BV <sup>(d)</sup>	Mobile cellular telephone system provider and operator	n/a	100% ordinary	Netherlands
Viag Interkom GmbH & Co <sup>(d)</sup>	Mobile cellular telephone system provider and operator	n/a	100% ordinary	Germany
Yell Limited	Classified directory advertising services provider	100% ordinary	100% ordinary	UK
Yellow Book USA Inc <sup>(d)</sup>	Classified directory publisher	100% common	100% common	USA
Yellow Pages Sales Limited <sup>(d)</sup>	Yellow Pages sales contractor	100% ordinary	100% ordinary	UK

#### Notes:

- The group comprises a large number of companies and it is not practical to include all of them in this list. The list, therefore, only includes those companies that have a more significant impact on the profit or assets of the group.
- The proportion of voting rights held corresponds to the aggregate interest percentage held by the holding company and subsidiary undertakings.
- All overseas undertakings are incorporated in their country of operations. Subsidiary undertakings operating internationally are all incorporated in England and Wales, except Farland BV and Syntegra (USA) Inc, which are incorporated in The Netherlands and USA, respectively.
- Held through intermediate holding company.
- In November 2000, Telecom Securicor Cellular Radio Limited changed its name to BT Cellnet Limited.
- In March 2001, Cellnet Group Limited changed its name to BT Wireless Limited and in September 2001 to O<sub>2</sub> Limited.
- On 17 April 2001, Telenor exercised a put option for BT to acquire its shareholding — Esat Digifone is now 100 per cent. owned.
- Formerly Control Data Systems Inc.
- Held by BT Cellnet Limited.

b = billions m = millions	Activity	Share capital				Country of operations <sup>(b)</sup>
		Issued <sup>(a)</sup>		Percentage owned		
		2001	2000	2001	2000	
<b>Joint Ventures</b>						
Airtel Movil SA <sup>(c)(d)</sup>	Mobile cellular telephone system provider and operator	Ptas 78b	Ptas 78b	17.8%	17.8%	Spain
Albacom SpA	Communication related services and products provider	ITL 543b	ITL 543b	45.5%	45.5%	Italy
Bharti Cellular Limited	Mobile cellular telephone system provider and operator	Rs1.05b	Rs1.05b	44%	44%	India
British Interactive Broadcasting Holdings Limited <sup>(g)</sup>	Digital tv interactive service provider	n/a	£0.1m	n/a	32.5%	UK
Concert BV	Global communication related services and products provider	NLG 50m	NLG 50m	100% <sup>(e)</sup>	100% <sup>(e)</sup>	International
e-peopleserve (Jersey) Limited	Human resource training and administration provider	£8.6m	n/a	50%	n/a	International
LG Telecom	Mobile cellular telephone system provider and operator	Won 953b	Won 953b	24.12%	24.12%	Republic of Korea
Springboard Internet Services Limited <sup>(f)</sup>	Internet service provider	£8.3m	£8.3m	50%	50%	UK
sunrise communications AG <sup>(h)</sup>	Communication related services and products provider	n/a	SFr 40m	n/a	34%	Switzerland
Telenordia AB	Communication related services and products provider	SKr106m	SKr106m	50%	33.3%	Sweden
Telfort BV <sup>(i)</sup>	Communication related services and products provider	n/a	NLG 0.5m	n/a	50%	Netherlands
VIAG INTERKOM GmbH & Co <sup>(j)</sup>	Communication related services and products provider	n/a	Partnership	n/a	45%	Germany

*Notes:*

- (a) Issued share capital comprises ordinary or common shares, unless otherwise stated. All investments are held through intermediate holding companies.
- (b) All overseas companies are incorporated in their country of operations, with the exception of Concert BV which is incorporated in The Netherlands.
- (c) Airtel Movil SA is being accounted for as a joint venture because of the relationship with other shareholders.
- (d) On 2 May 2001, BT announced that subject to regulatory and procedural approvals Vodafone has agreed to purchase its interest in Airtel Movil SA.
- (e) 100 per cent. of ordinary 'B' shares held giving an effective economic interest of 50 per cent.
- (f) BT sold its interest in Springboard Internet Services Limited on 25 April 2001.
- (g) Reclassified as a trade investment in the year ended 31 March 2001.
- (h) BT sold its interest in sunrise communications AG in November 2000.
- (i) On 22 June 2000, BT received regulatory approval to acquire the remaining 50 per cent. interest of Telfort BV.
- (j) On 20 February 2001, the group took full control of Viag Interkom GmbH & Co.

## Part 5: Financial information on BT and BT Group

b = billions m = millions	Activity	Share capital				Country of operations <sup>(b)</sup>
		Issued <sup>(a)</sup>		Percentage owned		
		2001	2000	2001	2000	
<b>Associates</b>						
AT&T BT Canada Holdings Limited Partnership <sup>(c)(i)</sup>	Partnership holding of a communications related services and products provider	n/a	Partnership	n/a	30% <sup>(c)</sup>	USA
Cegetel SA	Communications related services and products provider	FFr 9.55b	FFr 9.55b	26%	26%	France
Cellular Operations Limited	Cellular telecommunications services provider	n/a	£0.15m	n/a	40%	UK
Japan Telecom Company Limited <sup>(d)</sup>	Communications related services and products provider	¥32b	¥32b	30% <sup>(d)</sup>	30% <sup>(e)</sup>	Japan
J-Phone Communications Co Limited <sup>(d)</sup>	Mobile cellular telephone system provider and operator	¥3.2b	n/a	20%	n/a	Japan
Maxis Communications Berhad <sup>(f)(g)(h)</sup>	Communications related services and products provider	Myr 158m	Myr 158m	33.3%	33.3%	Malaysia
Rogers Wireless Communications Inc	Mobile cellular telephone system provider and operator	n/a	n/a	16.8% <sup>(i)</sup>	16.8% <sup>(i)</sup>	Canada
SmarTone Telecommunications Holdings Limited	Mobile cellular telephone system provider and operator	HK\$60m	HK\$60m	20.05%	20.05%	Hong Kong
The Link Stores Limited	Telecommunications equipment retailer	£80	£80	40%	40%	UK

### Notes:

- (a) Issued share capital comprises ordinary or common shares, unless otherwise stated. All investments are held through intermediate holding companies.
- (b) All overseas undertakings are incorporated in their country of operations.
- (c) Holds an effective 31 per cent. economic interest in AT&T Canada Corporation.
- (d) On 2 May 2001, BT announced that subject to regulatory and procedural approvals Vodafone has agreed to purchase its interests in Japan Telecom Company Limited and J-Phone Communications Co Limited.
- (e) Held through a BT subsidiary company — 66.7 per cent. BT owned, 33.3 per cent. AT&T owned. Economic holding is 20 per cent.
- (f) Certain exchange control constraints operate in Malaysia.
- (g) Formerly Binariang Berhad.
- (h) On 4 May 2001, BT announced that it had agreed in principle to sell its interest in Maxis Communications, subject to regulatory and other approvals.
- (i) Held through a 50 per cent. interest in an intermediary company, which holds 33.6 per cent. of Rogers Wireless Communications Inc.
- (j) Reclassified as a trade investment in the year ended 31 March 2001.



### **3. Pro Forma financial information:**

#### **profit and loss account for the year ended 31 March 2001 and balance sheet as at 30 June 2001**

##### **Introduction**

The following unaudited pro forma consolidated financial information has been prepared, for illustrative purposes only, to show primarily the effects on the profit and loss account of BT of the Demerger as if it had become effective on 1 April 2000 and on the balance sheet of BT as if the Demerger had become effective on 30 June 2001.

The unaudited pro forma consolidated financial information also shows the effects of major transactions which were completed by BT since 1 April 2000. These major transactions are the acquisition of the full ownership of Viag Interkom, the Rights Issue, the sale of the Yell business and the sale of BT's Japanese investments. The pro forma profit and loss information reflects these transactions as if they had occurred immediately prior to 1 April 2000. The major transactions listed above had completed prior to 30 June 2001 and consequently their effect is already reflected in the actual BT balance sheet at that date.

##### **Viag Interkom**

BT took full ownership of Viag Interkom by purchasing the remaining stakes from Viag Interkom's other shareholders in January and February 2001 for £5.6 billion. As part of this purchase, BT also repaid loans totalling £2.9 billion between Viag Interkom and its other shareholders, which, together with a £2.3 billion loan from BT, had been used to fund Viag Interkom's £5.2 billion purchase of its UMTS licence. These payments were primarily funded by the issuance of long-term debt.

##### **Rights issue**

BT completed a rights issue which closed on 15 June 2001 under which net proceeds of approximately £5.9 billion were raised from the issue of 1,975,580,052 Ordinary Shares.

##### **Yell**

On 25 June 2001, BT completed the sale of the Yell classified directory advertising business for proceeds of approximately £2 billion.

##### **Japan**

In June 2001, BT completed the sale of its 20 per cent. interests in Japan Telecom and J-Phone Communications KK for net proceeds of £3.3 billion, after taking into account an option payment of £0.4 billion in June 2001.

The unaudited pro forma financial information below has been included for illustrative purposes only and, because of its nature, may not give a true and fair picture of the consolidated results and the financial position of BT Group plc following the completion of the Demerger and the other major transactions described.

## Part 5: Financial information on BT and BT Group

### Pro forma consolidated profit and loss account for BT Group plc for the year ended 31 March 2001

	Historical BT	BT pro forma adjustments	Pro forma BT prior to the Demerger	Adjustments for mmO <sub>2</sub>	Eliminations and other	Pro forma BT Group
	(note 1a) £m	(note 1b) £m	£m	(note 1g) £m	(note 1i) £m	£m
<b>Group turnover</b>	20,427	203	20,630	(4,109)	851	17,372
Other operating income	393	—	393	—	—	393
Operating costs	(20,759)	(1,302)	(22,061)	7,992	(851)	(14,920)
Group operating profit (loss)	61	(1,099)	(1,038)	3,883	—	2,845
Group's share of operating loss of joint ventures and associates	(397)	(99)	(496)	29	—	(467)
Total operating profit (loss)	(336)	(1,198)	(1,534)	3,912	—	2,378
Profit on sale of group undertakings and fixed asset investments	619	—	619	—	—	619
Net interest payable	(1,314)	230	(1,084)	260	—	(824)
<b>Profit (loss) on ordinary activities before taxation</b>	(1,031)	(968)	(1,999)	4,172	—	2,173
Tax on profit (loss) on ordinary activities	(652)	275	(377)	(69)	—	(446)
<b>Profit (loss) on ordinary activities after taxation</b>	(1,683)	(693)	(2,376)	4,103	—	1,727
Minority interests	(127)	125	(2)	4	—	2
<b>Profit (loss) for the financial year</b>	(1,810)	(568)	(2,378)	4,107	—	1,729

Pro forma consolidated balance sheet for BT Group plc  
as at 30 June 2001

	Historical BT (note 1a) £m	Adjustments for mmO <sub>2</sub> (note 1g) £m	Adjustment for mmO <sub>2</sub> net debt (note 1h) £m	Pro forma BT Group £m
<b>Fixed assets</b>				
Intangible assets	18,297	(15,998)	—	2,299
Tangible assets	21,610	(3,877)	—	17,733
Investments	3,675	(30)	—	3,645
<b>Total fixed assets</b>	<b>43,582</b>	<b>(19,905)</b>	<b>—</b>	<b>23,677</b>
<b>Current assets</b>				
Stocks	289	(145)	—	144
Debtors	7,380	(1,602)	—	5,778
Investments	10,754	(495)	133	10,392
Cash at bank and in hand	388	(343)	343	388
<b>Total current assets</b>	<b>18,811</b>	<b>(2,585)</b>	<b>476</b>	<b>16,702</b>
<b>Creditors: amounts falling due within one year</b>				
Loans and other borrowings	(10,990)	5,777	(5,277)	(10,490)
Other creditors	(8,961)	2,107	—	(6,854)
<b>Total creditors: amounts falling due within one year</b>	<b>(19,951)</b>	<b>7,884</b>	<b>(5,277)</b>	<b>(17,344)</b>
<b>Net current assets (liabilities)</b>	<b>(1,140)</b>	<b>5,299</b>	<b>4,801</b>	<b>(642)</b>
<b>Total assets less current liabilities</b>	<b>42,442</b>	<b>(14,606)</b>	<b>4,801</b>	<b>23,035</b>
<b>Creditors: amounts falling due after more than one year</b>				
Loans and other borrowings	(17,633)	11,481	11,119	(17,271)
Provisions for liabilities and charges	(2,769)	191	—	(2,578)
<b>Total net assets (liabilities)</b>	<b>22,040</b>	<b>(2,934)</b>	<b>(15,920)</b>	<b>3,186</b>
Minority interests	82	—	—	82
Capital and reserves	21,958	(2,934)	(15,920)	3,104
	<b>22,040</b>	<b>(2,934)</b>	<b>(15,920)</b>	<b>3,186</b>

## Part 5: Financial information on BT and BT Group

### Notes to the pro forma consolidated financial information on BT Group plc

#### 1. Basis of preparation

The unaudited pro forma consolidated financial information has been prepared on a basis consistent with BT's accounting policies.

#### BT

- (a) Financial information in respect of BT for the year ended 31 March 2001 has been extracted without material adjustment from the annual report and accounts for the year ended 31 March 2001 and financial information as at 30 June 2001 has been extracted without material adjustment from the unaudited first quarter results to 30 June 2001 of BT.

No account has been taken of trading of any constituent part of BT since 31 March 2001 for the profit and loss account, or for the balance sheet since 30 June 2001.

#### BT pro forma adjustments

- (b) BT pro forma profit and loss account adjustments reflect the impact of transactions which have been or are to be made by BT before the Demerger, described in more detail below:

	Acquisition of Viag Interkom (note 1c) £m	Rights Issue (note 1d) £m	Sale of Yell (note 1e) £m	Sale of Japanese investments (note 1f) £m	Total BT adjustments £m
Impact on:					
Group turnover	978	—	(775)	—	203
Operating costs	(1,891)	—	589	—	(1,302)
<b>Group operating profit (loss)</b>	<b>(913)</b>	<b>—</b>	<b>(186)</b>	<b>—</b>	<b>(1,099)</b>
Group's share of operating loss of joint ventures and associates	277	—	(2)	(374)	(99)
<b>Total operating profit (loss)</b>	<b>(636)</b>	<b>—</b>	<b>(188)</b>	<b>(374)</b>	<b>(1,198)</b>
Profit on sale of group undertakings and fixed asset investments	—	—	—	—	—
Net interest payable	(596)	382	155	289	230
<b>Profit (loss) on ordinary activities before tax</b>	<b>(1,232)</b>	<b>382</b>	<b>(33)</b>	<b>(85)</b>	<b>(968)</b>
Tax on profit (loss) on ordinary activities	301	(115)	19	70	275
<b>Profit (loss) on ordinary activities after taxation</b>	<b>(931)</b>	<b>267</b>	<b>(14)</b>	<b>(15)</b>	<b>(693)</b>
Minority interest	—	—	—	125	125
<b>Profit (loss) for the financial year</b>	<b>(931)</b>	<b>267</b>	<b>(14)</b>	<b>110</b>	<b>(568)</b>

#### Acquisition of Viag Interkom

- (c) BT's interest in Viag Interkom was accounted for as a joint venture interest in the period from 1 April 2000 to 19 February 2001 and as a subsidiary in the period from 20 February 2001. For the purposes of the pro forma consolidated financial information, adjustments have been made to account for Viag Interkom as if it had been a subsidiary undertaking throughout the year ended 31 March 2001. Accordingly this column incorporates the results of Viag Interkom for the period from 1 April 2000 to 19 February 2001, the amortisation of goodwill arising on consolidation and the interest charge on the incremental debt taken on to fund the acquisition and also eliminates the share of Viag Interkom's results taken up by BT whilst it was a joint venture. The results of Viag Interkom are extracted without material adjustment from the return of Viag Interkom prepared for inclusion in the consolidated BT results for the year ended 31 March 2001. The adjustments in respect of Viag Interkom are as disclosed in the Rights Issue prospectus issued by BT on 10 May 2001.

Pro forma profit and loss account adjustments in respect of BT's acquisition of Viag Interkom reflect:

	Eliminate share of Viag Interkom's results as associate (i) £m	Eliminate Viag Interkom as subsidiary (ii) £m	Add Viag Interkom's results for year to 31 March 2001 (iii) £m	Interest on incremental debt (iv) £m	Pro forma goodwill (v) £m	Tax credit for Viag Interkom losses (vi) £m	Total adjustments for acquisition of Viag Interkom (vii) £m
Impact on:							
Group turnover	—	(100)	1,078	—	—	—	978
Operating costs	—	193	(1,855)	—	(229)	—	(1,891)
<b>Group operating profit (loss)</b>	—	93	(777)	—	(229)	—	(913)
Group's share of operating loss of joint ventures and associates	277	—	—	—	—	—	277
<b>Total operating profit (loss)</b>	277	93	(777)	—	(229)	—	(636)
Profit on sale of group undertakings and fixed asset investments	—	(12)	12	—	—	—	—
Net interest payable	70	28	(176)	(518)	—	—	(596)
<b>Profit (loss) on ordinary activities before tax</b>	347	109	(941)	(518)	(229)	—	(1,232)
Tax on profit (loss) on ordinary activities	(104)	(32)	—	155	—	282	301
<b>Profit (loss) on ordinary activities after taxation</b>	243	77	(941)	(363)	(229)	282	(931)

*Notes:*

- (i) Elimination of the share of results for Viag Interkom as an associate, and related tax credit arising from group relief on Viag Interkom's losses, for the period from 1 April 2000 to 19 February 2001.
- (ii) Elimination of the accounting for Viag Interkom as a subsidiary and related tax credit arising from group relief on Viag Interkom's losses, from 20 February 2001 to 31 March 2001.
- (iii) Addition of full results for Viag Interkom as a subsidiary from 1 April 2000 to 31 March 2001.
- (iv) An increase in interest payable of £518 million, to reflect the purchase of the remaining 55 per cent. of Viag Interkom for £5.6 billion as if it had occurred on 1 April 2000 and the total cost of funding Viag Interkom's UMTS licence of £5.2 billion based on the increase in long-term fixed rate debt at the average rate to BT for the year ended 31 March 2001 of 7.1 per cent. Tax relief on the additional interest has been reflected at 30 per cent.
- (v) Adjustment to the goodwill amortisation charge by £229 million in respect of the goodwill arising on the acquisition of the additional stake in Viag Interkom to incorporate a full year's charge. A goodwill impairment charge of £3,000 million was made at 31 March 2001 and thus the full year's amortisation charge is expected to be £100 million from 1 April 2001 based on the revised book value of goodwill and exchange rates ruling at 1 April 2001.
- (vi) Adjustment to BT's tax charge to reflect group relief for Viag Interkom's losses for the year ended 31 March 2001 at 30 per cent.
- (vii) This column shows the total adjustment relating to the acquisition of Viag Interkom's fixed and mobile businesses. The mobile element is analysed within note 1(h).

**Rights Issue**

- (d) BT received gross proceeds of £5,928 million in June 2001 on the completion of the Rights Issue of 1,975,580,052 shares at 300 pence per share which, after deduction of costs of £52 million, gave net proceeds of £5,876 million.

The proceeds of the Rights Issue have been allocated to reduce short-term debt. Accordingly the impact on BT's net interest payable has been calculated as if the proceeds from the Rights Issue were received on 1 April 2000, with a resulting reduction in the annual interest charge of £382 million based on BT's average interest rate for short-term debt of 6.5 per cent. for the year ended 31 March 2001. Tax on this interest has been included at the UK tax rate for the year ended 31 March 2001 of 30 per cent.

The adjustments in respect of the Rights Issue are consistent with those disclosed in the Rights Issue Prospectus dated 10 May 2001.

**Sale of Yell**

- (e) BT completed the sale of its Yell business on 25 June 2001 for proceeds of approximately £2 billion. The pro forma profit and loss account reflects this sale as if it had occurred on 1 April 2000 by eliminating the results of the Yell business for the year ended 31 March 2001. The information relating to Yell has been extracted without material adjustment from the return prepared for inclusion in the consolidated BT results for the year ended 31 March 2001 as referred to in note 1(a) above. The impact on BT's net interest payable has been calculated as if the proceeds from the sale were received on 1 April 2000, with a resulting reduction in the annual interest charge of £130 million based on BT's average interest rate for short-term debt of

## Part 5: Financial information on BT and BT Group

6.5 per cent. for the year ended 31 March 2001. Tax on this interest has been included at the UK tax rate for the year ended 31 March 2001 of 30 per cent.

### Sale of Japanese investments

- (f) BT completed the sale of its 20 per cent. interest in Japan Telecom and its 20 per cent. interest in J-Phone Communications KK on 1 June 2001 and subsequently its interest in J-Phone group companies for net proceeds of £3.32 billion. Prior to that date these investments were accounted for as associated undertakings. The pro forma profit and loss account reflects these sales as if they had occurred on 1 April 2000 by eliminating the share of the results of the Japanese businesses included in the group results for the year ended 31 March 2001. The information relating to the Japanese investments has been extracted without material adjustment from the return prepared for inclusion in the consolidated BT results for the year ended 31 March 2001 as referred to in note 1(a) above. The impact on BT's net interest payable has been calculated as if the proceeds from the sales were received on 1 April 2000, with a resulting reduction in the annual interest charge of £216 million based on BT's average interest rate for short-term debt of 6.5 per cent. for the year ended 31 March 2001. Tax on this interest has been included at the UK tax rate for the year ended 31 March 2001 of 30 per cent.

### mmO<sub>2</sub>

#### (g) Profit and loss account

The information relating to mmO<sub>2</sub> has been extracted from the group returns used to prepare the consolidated accounts of BT for the year ended 31 March 2001. It has been adjusted for the pro forma mmO<sub>2</sub> share of the results of Viag Interkom for the year ended 31 March 2001 and for the pro forma goodwill amortisation charge arising as set out below.

	mmO <sub>2</sub> (i) £m	mmO <sub>2</sub> share of Viag Interkom (ii) £m	Other pro forma adjustments (iii) £m	Pro forma mmO <sub>2</sub> £m
Impact on:				
Group turnover	(3,399)	(710)	—	(4,109)
Operating costs	6,527	1,287	178	7,992
<b>Group operating profit (loss)</b>	<b>3,128</b>	<b>577</b>	<b>178</b>	<b>3,883</b>
Group's share of operating loss of joint ventures and associates	289	(260)	—	29
<b>Total operating profit (loss)</b>	<b>3,417</b>	<b>317</b>	<b>178</b>	<b>3,912</b>
Net interest payable	177	83	—	260
<b>Profit (loss) on ordinary activities before tax</b>	<b>3,594</b>	<b>400</b>	<b>178</b>	<b>4,172</b>
Tax on profit (loss) on ordinary activities	(69)	—	—	(69)
<b>Profit (loss) on ordinary activities after taxation</b>	<b>3,525</b>	<b>400</b>	<b>178</b>	<b>4,103</b>
Minority interests	4	—	—	4
<b>Loss attributable to shareholders and transfer from reserves for the financial year</b>	<b>3,529</b>	<b>400</b>	<b>178</b>	<b>4,107</b>

#### Notes:

- (i) mmO<sub>2</sub> results extracted without material adjustment from group returns used to prepare the consolidated accounts of BT for the year ended 31 March 2001.
- (ii) As stated in note 1(c) the BT pro forma information incorporates the results of Viag Interkom as if it had been a subsidiary undertaking throughout the year ended 31 March 2001. This column therefore reflects the Viag Interkom results for this period which have been allocated to mmO<sub>2</sub>. The full results of Viag Interkom for this period are shown in note 1(c).
- (iii) This column represents an adjustment to the goodwill amortisation charge by £178 million in respect of the goodwill arising on the acquisition of the additional stake in Viag Interkom to incorporate a full year's charge. A goodwill impairment charge of £2,800 million relating to the mmO<sub>2</sub> element of Viag Interkom has been made at 31 March 2001 and thus the full year's amortisation charge is expected to be £45 million from 1 April 2001 based on the revised book value of goodwill.

**Balance sheet**

The mmO<sub>2</sub> balance sheet at 30 June 2001 has been extracted without material adjustment from the group returns of mmO<sub>2</sub> prepared for inclusion in the BT results at 30 June 2001.

- (h) On Demerger, BT's net investment in mmO<sub>2</sub> and loans to mmO<sub>2</sub> will be reduced to give mmO<sub>2</sub> net debt of approximately £500 million upon separation. The balance sheet of mmO<sub>2</sub> at 30 June 2001 has therefore been adjusted to exclude certain balances to give mmO<sub>2</sub> net debt of approximately £500 million.

**Eliminations and other**

- (i) The adjustment reflects intra-group transactions between BT Group and the discontinued operations of BT, principally mmO<sub>2</sub>, eliminated upon consolidation of the then existing BT group for the year ended 31 March 2001.



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18 September 2001

Dear Sirs

**BT Group plc (“the Company”)**

We report on the pro forma financial information set out in Part 5 of the Company’s listing particulars dated 18 September 2001. The pro forma financial information has been prepared, for illustrative purposes only, to provide information about how the proposed demerger of the mmO<sub>2</sub> business (as defined in the listing particulars) might have affected the consolidated balance sheet of British Telecommunications public limited company and its subsidiaries (“BT”) as at 30 June 2001 and how the proposed demerger of the mmO<sub>2</sub> business, the acquisition of Viag Interkom, the Rights Issue, the sale of Yell and BT’s Japanese investments might have affected the consolidated profit and loss account of BT for the year ended 31 March 2001.

**Responsibilities**

It is the responsibility solely of the directors of the Company to prepare the pro forma financial information in accordance with paragraph 12.29 of the Listing Rules of the UK Listing Authority (“the Listing Rules”).

It is our responsibility to form an opinion, as required by the Listing Rules, on the pro forma financial information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the pro forma financial information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

**Basis of opinion**

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards and Bulletin 1998/8 “Reporting on pro forma financial information pursuant to the Listing Rules” issued by the Auditing Practices Board. Our work, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the pro forma financial information with the directors of the Company.

Our work has not been carried out in accordance with auditing standards generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards.



**Opinion**

In our opinion:

- (a) the pro forma financial information has been properly compiled on the basis stated;
- (b) such basis is consistent with the accounting policies of the Company; and
- (c) the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to paragraph 12.29 of the Listing Rules.

Yours faithfully

PricewaterhouseCoopers  
*Chartered Accountants*

# Part 6: Taxation

Paragraphs 1, 2 and 3 of this Part 6 provide information about the tax consequences of holding BT Group Shares and BT Group ADSs for shareholders resident for tax purposes in the UK, the US and The Netherlands, respectively.

Shareholders who are in any doubt as to their tax position, or who are resident in any other jurisdiction, should consult a professional adviser immediately.

## 1. UK taxation

*The comments below are based on existing UK law and what is understood to be current Inland Revenue practice, both of which are subject to change at any time, possibly with retrospective effect. They are intended only as a general guide and apply only to shareholders who are resident and ordinarily resident for tax purposes in (and only in) the UK (except insofar as express reference is made to the treatment of non-UK residents), who hold BT Group Shares as an investment and who are the absolute beneficial owners of such shares. The taxation position of certain shareholders who are subject to special rules, such as dealers in securities, broker-dealers, insurance companies and collective investment schemes is not considered. Persons who are in any doubt about their tax position, or who are resident or otherwise subject to taxation in a jurisdiction outside the UK, should consult their own professional advisers.*

### Dividends

The Company will not be required to withhold tax at source when paying a dividend.

An individual shareholder who is resident in the UK for tax purposes and who receives a dividend from the Company will be entitled to a tax credit which such shareholder may set off against his total income tax liability on the dividend. The tax credit will be equal to 10 per cent. of the aggregate of the dividend and the tax credit (the “gross dividend”), which is also equal to one-ninth of the cash dividend received. A UK resident individual shareholder who is liable to income tax at the starting or basic rate will be subject to tax on the dividend at the rate of 10 per cent. of the gross dividend, so that the tax credit will satisfy in full such shareholder’s liability to income tax in respect of the gross dividend. Generally a UK resident individual shareholder who is not liable to income tax in respect of the gross dividend will not be entitled to repayment of the tax credit. In the case of a UK resident individual shareholder who is liable to income tax at the higher rate, the tax credit will be set against but not fully match his tax liability on the gross dividend and he will have to account for additional tax equal to 22.5 per cent. of the gross dividend (which is also equal to 25 per cent. of the cash dividend received) to the extent that the gross dividend when treated as the top slice of his income falls above the threshold for higher rate income tax.

UK resident taxpayers who are not liable to UK tax on dividends, including pension funds and charities, will not be entitled to claim repayment of the tax credit attaching to dividends paid by BT Group, although charities will be entitled to limited compensation in lieu of repayable tax credits in respect of dividends paid on or before 5 April 2004.

Tax credits on dividends paid by the Company in respect of shares held in PEPs or ISAs will be repayable for dividends paid on or before 5 April 2004.

UK resident corporate shareholders will generally not be subject to corporation tax on dividends paid by the Company. Those shareholders will not be able to claim repayment of tax credits attaching to dividends.

In general, the right of non-UK resident holders of BT Group Shares to reclaim tax credits attaching to dividend payments will depend upon the terms of any applicable double tax treaty which exists between the jurisdiction in which they are resident and the UK. Other than in exceptional circumstances, the amount of any tax credit that non-UK resident holders of BT Group Shares will be able to reclaim in respect of any dividend payment will be reduced to nil as a result of the terms of the relevant treaty. A shareholder resident outside the UK may also be subject to foreign taxation on dividend income under local law. A shareholder who is not resident in the UK should consult his own tax adviser concerning his tax position in respect of dividends received from the Company.

### Capital Gains Tax

A subsequent disposal of BT Group Shares by a shareholder who is resident or, in the case of an individual, ordinarily resident in the UK may, depending on a shareholder’s personal circumstances, give rise to a liability to taxation of capital gains (“CGT”).

A holder of BT Group Shares who is neither resident nor ordinarily resident in the UK but who carries on a trade, profession or vocation in the UK through a branch or an agency to which the BT Group Shares are attributable may be subject to CGT on a disposal of such shares.

Individuals who are temporarily non-UK resident may, in certain circumstances, be subject to tax in respect of gains realised whilst they are not resident in the UK.

### **Stamp Duty and Stamp Duty Reserve Tax (“SDRT”)**

A transfer of, or agreement to transfer, BT Group Shares will generally be subject to stamp duty or SDRT, at the rate of 0.5 per cent. of the consideration paid (rounded up to the next multiple of £5 in the case of stamp duty). Stamp duty or SDRT is normally the liability of the purchaser or transferee of the BT Group Shares. An unconditional agreement to transfer such shares will normally give rise to SDRT, at the rate of 0.5 per cent. of the amount or value of the consideration paid for such shares, but such liability will be cancelled, and any SDRT paid refunded, if the agreement is completed by a duly stamped transfer within six years of the agreement having become unconditional.

Where BT Group Shares are issued or transferred (a) to, or to a nominee for, a person whose business is or includes the provision of clearance services or (b) to, or to a nominee or agent for, a person whose business is or includes issuing depository receipts, stamp duty or SDRT will be payable at the higher rate of 1.5 per cent. of the amount or value of the consideration payable, or in certain circumstances, the value of the BT Group Shares (rounded up to the next multiple of £5 in the case of stamp duty). This liability to stamp duty or SDRT will strictly be for the account of the depository or clearance service operator or their nominee, as the case may be, but will, in practice, generally be reimbursed by participants in the clearance service or depository receipt scheme. The Company will pay any such SDRT that arises as a result of the issue of BT Group ADSs under the Demerger. Transfers of shares within the clearance service and transfers of ADSs will not be subject to stamp duty or SDRT (subject to the clearance service not opting for SDRT to apply to such transfers as set out in the following sentence) provided that any document used to effect such transfer is executed and retained outside the UK. Clearance services may opt, provided certain conditions are satisfied, for the normal rate of stamp duty or SDRT (generally 0.5 per cent. of the consideration paid rounded up to the next multiple of £5 in the case of stamp duty) to apply to issues or transfers of BT Group Shares into, and to transactions within, such services instead of the higher rate of 1.5 per cent. generally applicable to an issue or a transfer of BT Group Shares into the clearance service and the exemption from stamp duty and SDRT on transfer of the BT Group Shares whilst in the service.

Under the CREST system for paperless share transfers, no stamp duty or SDRT will arise on a transfer of shares into the system, unless the transfer into CREST is itself for consideration in money or money’s worth, in which case a liability to SDRT will arise, usually at the rate of 0.5 per cent. of the amount or value of the consideration given. Transfers of shares within CREST are generally liable to SDRT (at a rate of 0.5 per cent. of the consideration paid) rather than stamp duty, and SDRT on relevant transactions settled within the system or reported through it for regulatory purposes will be collected and accounted for to the Inland Revenue by CRESTCo.

The above statements are intended as a general guide to the current stamp duty and SDRT position. Certain categories of person are not liable to stamp duty or SDRT and others may be liable at a higher rate. Certain categories of person may, although not primarily liable for tax, be required to notify and account for it under the Stamp Duty Reserve Tax Regulations 1986.

### **Inheritance and Gift Taxes**

The BT Group Shares and the BT Group ADSs are likely to be, assets situated in the UK for the purposes of UK inheritance tax. A gift of such assets by, or the death of, an individual holder of such assets might (subject to certain exemptions and reliefs) give rise to a liability to UK inheritance tax, even if the holder is neither domiciled in the UK nor deemed to be domiciled there under certain rules relating to long residence or previous domicile. For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift.

## **2. US taxation**

The following is a discussion of material US federal income tax consequences of the ownership and disposition of BT Group Shares or BT Group ADSs by US Holders (as defined below) who hold their shares or ADSs as capital assets. This discussion is based on US federal income tax laws, including the Internal Revenue Code of 1986, as amended (the “Internal Revenue Code”), Treasury regulations, rulings, judicial decisions and administrative pronouncements, and on existing UK tax law and UK Inland Revenue practice, including the US-UK Income Tax Convention (the “existing tax treaty”), all as currently in effect, and all of which are subject to change or changes in interpretation, possibly with retroactive effect. The US and the UK signed a new US-UK Income Tax Convention (the “new tax treaty”) on 24 July 2001, the provisions of which will not enter into force until the Convention has completed its passage through the US Senate and the UK Parliament and has been ratified by both governments.

## **Part 6: Taxation**

The discussion below notes the instances in which the relevant provisions of the new tax treaty would produce a materially different result for a US Holder.

This discussion does not address all aspects of US federal income taxation that may apply to holders subject to special tax rules, including US expatriates, insurance companies, tax-exempt organizations, financial institutions, securities broker-dealers, persons subject to the alternative minimum tax, investors that actually or constructively own 10 per cent. or more of the outstanding share capital of the Company, persons holding their BT Group Shares or BT Group ADSs as part of a straddle, hedging transaction or conversion transaction, persons who acquired their BT Group Shares or BT Group ADSs pursuant to the exercise of options or similar derivative securities or otherwise as compensation, or persons whose functional currency is not the US dollar, among others. Those holders may be subject to US federal income tax consequences different from those described below.

For purposes of this discussion, a “US Holder” is a beneficial owner of BT Group Shares or BT Group ADSs that, for US federal income tax purposes, is an individual citizen or resident of the United States, a corporation created or organized in or under the laws of the United States or any state thereof, an estate whose income is subject to US federal income taxation regardless of its source or a trust if a US court can exercise primary supervision over the administration of the trust and one or more US persons are authorized to control all substantial decisions of the trust.

All holders of BT Group Shares or BT Group ADSs should consult their own tax advisors concerning the specific US federal, state and local tax consequences applicable in light of their particular situations as well as any consequences arising under the laws of any other taxing jurisdiction.

For US federal income tax purposes and for purposes of the existing tax treaty, a US Holder of BT Group ADSs will be treated as owning the underlying BT Group Shares represented thereby. Accordingly, the following discussion (except where otherwise expressly noted) applies equally to US Holders of BT Group Shares and to US Holders of BT Group ADSs.

### **Taxation of Dividends**

The gross amount of distributions paid (including any additional dividend income arising from a foreign tax credit claim as described below), to a US Holder by the Company will be taxable as ordinary income to the US Holder for US federal income tax purposes to the extent paid out of the Company current or accumulated earnings and profits, as determined for US federal income tax purposes, based on the US dollar value of the distribution calculated by reference to the spot rate in effect on the date the distribution is actually or constructively received by a US Holder, in the case of BT Group Shares, or by the ADS Depositary, in the case of BT Group ADSs. Distributions by the Company in excess of current and accumulated earnings and profits will be treated first as a tax-free return of capital to the extent of the US Holder’s basis in the BT Group Shares, thus reducing the US Holder’s adjusted tax basis in such BT Group Shares and, thereafter, as a capital gain. For foreign tax credit limitation purposes, dividends paid by the Company will be income from sources outside the United States. Dividends paid by the Company will not be eligible for the dividends-received deduction generally allowed to US corporations in respect of dividends received from other US corporations.

Dividends paid with respect to the BT Group Shares will be treated as “passive income” or, in the case of certain US Holders, “financial services income”, for purposes of computing allowable foreign tax credits for US federal income tax purposes. Under the existing tax treaty, a US Holder that is eligible for benefits with respect to income derived in connection with the BT Group Shares (each such holder referred to as an “eligible US Holder”) and that claims the benefits of the existing tax treaty with respect to a dividend from BT Group plc will be entitled to a foreign tax credit for the UK tax notionally withheld with respect to such dividend. If an eligible US Holder is so entitled, the foreign tax credit would be equal to one-ninth of any dividend received and would give rise to additional dividend income in the same amount. Each eligible US Holder that relies on the existing tax treaty to claim a foreign tax credit under these circumstances must file IRS Form 8833 (Treaty-Based Return Position Disclosure) disclosing this reliance with his US federal income tax return for the year in which the foreign tax credit is claimed. Alternatively, a US Holder may claim all foreign tax paid during a particular taxable year as an itemized deduction. A deduction does not reduce US federal income tax on a dollar for dollar basis like a tax credit. The deduction, however, is not subject to the limitations described above.

The rules governing the foreign tax credit are complex. Each US Holder is urged to consult his own tax advisor concerning whether the US Holder is eligible for benefits under the existing tax treaty, whether, and to what extent, a foreign tax credit will be available under the existing tax treaty with respect to dividends received from the Company, and whether the US Holder will be eligible for benefits under the new tax treaty.

US Holders are advised that under the new tax treaty (pending ratification) there would be no notional UK withholding tax applied to a dividend payment and it therefore would not be possible to claim a foreign tax credit in respect of any dividend payment made by the Company.

A US Holder will have a basis in any pounds sterling distributed, for US federal income tax purposes, equal to the US dollar value of pounds sterling on the date of payment. Any gain or loss recognized upon a subsequent disposition of pounds sterling will generally be ordinary income or loss. Each US Holder should consult his own tax advisor concerning the treatment of any foreign currency gain or loss on any pounds sterling received with respect to the BT Group Shares that are not converted into US dollars on the date the pounds sterling are actually or constructively received.

### **Taxation of Capital Gains**

In general, upon a sale, exchange or other disposition of BT Group Shares, a US Holder will recognize capital gain or loss for US federal income tax purposes in an amount equal to the difference between the US dollar value of the amount realized on the disposition and the US Holder's tax basis, determined in US dollars, in the BT Group Shares. Such gain or loss generally will be US source gain or loss, and will be treated as a long-term capital gain or loss if the US Holder's holding period in the BT Group Shares exceeds one year. The deductibility of capital losses is subject to significant limitations. If the US Holder is an individual, any capital gain generally will be subject to US federal income tax at preferential rates if specified minimum holding periods are met.

### **US Information Reporting and Backup Withholding**

Dividend payments made to a holder and proceeds paid from the sale, exchange, or other disposition of a holder's BT Group Shares may be subject to information reporting to the IRS and possible US federal backup withholding at a rate of up to 30.5 per cent. Certain exempt recipients (such as corporations) are not subject to these information reporting requirements. Backup withholding will not apply to a holder who furnishes a correct taxpayer identification number or certificate of foreign status and makes any other required certification, or who is otherwise exempt from backup withholding. US persons who are required to establish their exempt status generally must provide IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Non-US holders generally will not be subject to US information reporting or backup withholding. However, such holders may be required to provide certification of non-US status in connection with payments received in the United States or through certain US-related financial intermediaries.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against a holder's US federal income tax liability. A holder may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS and furnishing any required information.

### **UK Stamp Duty and Stamp Duty Reserve Tax**

See the section "UK taxation – Stamp Duty and Stamp Duty Reserve Tax" which applies equally to US Holders of BT Group Shares or BT Group ADSs.

### **3. Netherlands taxation**

*The comments below are based on existing Dutch tax law, which is subject to change, possibly with retrospective effect. They are intended only as a general guide and apply only to shareholders who are resident and ordinarily resident for tax purposes in The Netherlands and who hold BT Shares or BT Group Shares or mmO<sub>2</sub> Shares, respectively, as an investment. Persons who are in any doubt about their tax position should consult their personal tax adviser on the specific implications in respect of the Scheme and the Demerger, and the subsequent ownership of BT Group Shares and mmO<sub>2</sub> Shares.*

The summary of certain Dutch taxes set out below is intended only for the following investors:

- (1) individuals who are resident or deemed to be resident in The Netherlands and, with respect to individual income taxation, individuals who opt to be taxed as residents of The Netherlands for the purposes of Dutch taxation and who hold BT Shares, BT Group Shares or mmO<sub>2</sub> Shares, respectively ("Dutch Individuals"), excluding individuals:
  - (a) who derive benefits from the BT Shares, BT Group Shares or mmO<sub>2</sub> Shares that are taxable as benefits from miscellaneous "activities" (*resultaat uit overige werkzaamheden*);

## Part 6: Taxation

- (b) for whom the BT Shares, BT Group Shares or mmO<sub>2</sub> Shares or any payment connected therewith may constitute employment income; or
  - (c) who have a substantial interest, or a deemed substantial interest, in BT, BT Group or mmO<sub>2</sub> plc, respectively; and
- (2) corporate entities (including associations which are taxed as corporate entities under Dutch tax law) that are resident or deemed to be resident in The Netherlands for the purposes of Dutch taxation and who invest in BT Shares, BT Group Shares or mmO<sub>2</sub> Shares (“Dutch Corporate Entities”) excluding:
- (a) corporate entities that are not subject to Dutch corporate income tax;
  - (b) pension funds (*pensioenfondsen*) and other entities that are exempt from Dutch corporate income tax;
  - (c) corporate entities for whom the BT Shares, BT Group Shares or mmO<sub>2</sub> Shares qualify as a participation, the benefits derived from which are exempt under the participation exemption (as laid down in the Dutch Corporate Income Tax Act 1969); and
  - (d) investment institutions (*beleggingsinstellingen*) as defined in the Dutch Corporate Income Tax Act 1969.

Generally, a shareholder will have a substantial interest if he owns alone or together with his partner, whether directly or indirectly, shares, or certain other rights over shares, representing 5 per cent. or more of the total issued and outstanding capital of a company (or the issued and outstanding capital of any class of shares of such company), or rights to acquire shares, whether or not already issued, that represent at any time 5 per cent. or more of the total issued and outstanding capital of the company (or the issued and outstanding capital of any class of shares of the company) or the ownership of certain profit participating certificates that relate to 5 per cent. or more of the annual profit and/or to 5 per cent. or more of the liquidation proceeds of the company. A shareholder will also have a substantial interest if certain relatives (including foster children) of that holder or his partner have a substantial interest in the company. If a holder of shares does not have a substantial interest, he will be deemed to have a substantial interest if a substantial interest (or part of a substantial interest) has been disposed of, or is deemed to have been disposed of, on a non-recognition basis.

### The Scheme

#### *Dutch Individuals not engaged or deemed to be engaged in an enterprise*

Generally, actual benefits derived under the Scheme by a Dutch individual holding BT Shares that are not attributable to an enterprise from which he derives profits as an entrepreneur or pursuant to a co-entitlement to the net worth of such enterprise other than as an entrepreneur or a shareholder (a “Dutch Private Individual”) are not subject to Dutch income tax.

#### *Dutch Individuals engaged or deemed to be engaged in an enterprise*

Any benefits derived or deemed to be derived under the Scheme by a Dutch Individual holding BT Shares that are attributable to an enterprise from which such Dutch Individual derives profits, whether as an entrepreneur or pursuant to a co-entitlement to the net worth of such enterprise, are generally subject to income tax at statutory rates.

#### *Dutch Corporate Entities*

Any benefits derived or deemed to be derived under the Scheme in respect of BT Shares that are held by a Dutch Corporate Entity are generally subject to corporate income tax at statutory rates.

### The Demerger

#### *Dutch Individuals not engaged or deemed to be engaged in an enterprise*

Generally, actual benefits derived by a Dutch Private Individual from the mmO<sub>2</sub> Shares pursuant to the Demerger are not subject to Dutch income tax.

#### *Dutch Individuals engaged or deemed to be engaged in an enterprise*

Any benefits derived or deemed to be derived pursuant to the Demerger by a Dutch Individual holding mmO<sub>2</sub> Shares that are attributable to an enterprise from which such Dutch Individual derives profits, whether as an entrepreneur or pursuant to a co-entitlement to the net worth of such enterprise, are generally subject to income tax at statutory rates.

#### *Dutch Corporate Entities*

Any benefits derived or deemed to be derived pursuant to the Demerger in respect of mmO<sub>2</sub> Shares that are held by a Dutch Corporate Entity are generally subject to corporate income tax at statutory rates.

## **Individual and Corporate Income and Capital Gains Tax**

### *Dutch Individuals not engaged or deemed to be engaged in an enterprise*

Generally, a Dutch Private Individual who holds BT Group Shares will be subject to a fictitious yield tax at a rate of 30 per cent. The tax is calculated on 4 per cent. of the average of the fair market value of the assets and liabilities of the Dutch Private Individual, which includes the BT Group Shares, at the beginning and at the end of each year (minus a tax-free amount). Actual benefits derived by a Dutch Private Individual from the BT Group Shares are not subject to Dutch income tax.

### *Dutch Individuals engaged or deemed to be engaged in an enterprise*

Any benefits derived or deemed to be derived by a Dutch Individual who holds BT Group Shares that are attributable to an enterprise from which such Dutch Individual derives profits, whether as an entrepreneur or pursuant to a co-entitlement to the net worth of such enterprise, are generally subject to income tax at statutory rates.

### *Dutch Corporate Entities*

Any benefits derived or deemed to be derived in respect of BT Group Shares that are held by a Dutch Corporate Entity are generally subject to corporate income tax at statutory rates.

## **Gift and Inheritance Taxes**

A liability to gift tax will arise in The Netherlands with respect to an acquisition of the BT Group Shares, by way of a gift by a Dutch Individual or a Dutch Corporate Entity. A liability to inheritance tax will arise in The Netherlands with respect to an acquisition or deemed acquisition of the BT Group Shares by way of an inheritance or bequest on the death of a Dutch Individual.

For the purposes of Dutch gift and inheritance taxes, an individual who holds Dutch nationality will be deemed to be resident in The Netherlands if he has been resident in The Netherlands at any time during the ten years preceding the date of the gift or his death. If, in the case of a gift of the BT Group Shares by an individual who at the time of the gift was a non-resident shareholder, such individual dies within 180 days after the date of the gift while (at the time of his death) being resident or deemed to be resident in The Netherlands, inheritance tax will be due. For the purposes of Dutch gift tax, an individual not holding Dutch nationality will be deemed to be resident in The Netherlands if he has been resident in The Netherlands at any time during the 12 months preceding the date of the gift.

## **Other Taxes and Duties**

No Dutch registration tax, transfer tax, stamp duty or any other similar documentary tax or duty will be payable in The Netherlands in respect of or in connection with the subscription, issue, placement, allotment or delivery of the BT Group Shares.

See the section “UK taxation – Stamp Duty and Stamp Duty Reserve Tax” for information on potential UK liabilities arising on transfers of BT Group Shares.

## *Part 7: Factors affecting the business*

The business of BT Group is affected by a number of factors, not all of which are wholly within BT Group's control. Although many of the factors influencing BT Group's performance are macro economic and likely to affect the performance of businesses generally, some aspects of BT Group's business make it particularly sensitive to certain areas of business risk. This paragraph highlights some of those specific areas. However, it does not purport to be an extensive analysis of the factors affecting the business and all of the information in this document should be considered when evaluating the Company.

### **Financing**

At 31 March 2001, BT's businesses had net debt of over £27.9 billion as a result of BT's significant investment and acquisition programme. Earlier in the 2001 financial year, BT's credit rating was downgraded anticipating both this increased level of debt and the decreased stability and predictability of revenue streams because of the view taken of the prospects for the telecommunications business. As a consequence, the cost of BT's borrowings rose. Approximately three quarters of BT Group's current long-term debt is subject to conditions which would increase the interest rate if BT Group was subject to further downgrades.

Since the year end, BT Group has made good progress in reducing its relative level of debt through the proceeds of the Rights Issue and as a result of the disposals of non-core assets and businesses. However, BT's net debt at 30 June 2001 was £17.5 billion and, whilst this is significantly less than at 31 March 2001, BT Group's gearing remains high and its interest cover remains low.

BT Group will continue to focus on debt reduction and cash generation and it expects to reduce its net debt to be between £15 billion and £17 billion at 31 March 2002, subject to the completion of the property transaction. BT Group now believes that its credit rating outlook is stable, although there can be no certainty that it will not be further downgraded. This would increase its borrowing costs and may hinder its ability to develop its business and affect its ability to raise short-term finance.

### **Dividends**

BT did not pay a final dividend for the year ended 31 March 2001 and its board has decided that there will be no interim dividend for the year ending 31 March 2002. The Board expects to recommend a final dividend for the BT Group in respect of the year ending 31 March 2002 and resume regular dividend payments thereafter. However, the level of dividends which the Company expects to pay is likely to be substantially lower than that paid by BT previously.

### **Regulatory**

Most of BT Group's fixed-network activities in the United Kingdom are subject to significant regulatory controls. The controls regulate, among other things, the prices BT Group may charge for its services and the extent to which it has to provide services to its competitors. In recent years, the effect of these controls has been to cause BT to reduce its prices. BT Group cannot assure its shareholders that the regulatory authorities will not increase the severity of the price controls, nor extend the services to which controls apply (including any new services that BT Group may offer in the future), nor extend the services which it has to provide its competitors. These controls may adversely affect BT Group's market share, the severity of competition and its future profitability.

### **Concert**

Concert, BT's joint venture with AT&T, continues to make losses and management is taking action aiming to improve its financial position. In addition, BT is in continuing discussions with AT&T concerning the future of the joint venture.

A number of alternatives to the joint venture are being considered. Options currently being considered include an unwinding of the Concert joint venture and there are a number of ways in which this might be accomplished. Any unwind is likely to include cash and non-cash restructuring costs which could be substantial. The actual amount of these costs will depend on the manner of implementation of any agreement and cannot be quantified at this time. Furthermore, in the event of an unwinding of the venture, Concert's future operating losses would be divided between AT&T and BT Group in accordance with any unwind agreement.

There can be no assurance that a timely or adequate agreement will be reached with AT&T regarding any of the alternatives under consideration. Relationships with customers could be adversely affected and key personnel could choose to leave the joint venture. Also, any agreement may require regulatory approval that might not be obtained or may not be obtained without considerable delay thus delaying implementation of any agreement. In the absence of any such agreement, the joint venture will continue in existence and as such may continue to incur sizeable losses and non-cash charges may be necessary.



### **Restructuring**

BT Group continues its substantial restructuring of its businesses to improve its position in a rapidly changing market place. This includes moving from a centrally organised structure to one based on several lines of business. Although the lines of business were mostly established by 1 July 2000 and BT Retail and BT Wholesale were split in October 2000, the detailed organisation continues to be developed and changed. BT Group's plans for the implementation of the restructuring are complete in many respects but remain outstanding in certain others, and, as a result, BT Group cannot assure its shareholders that completion of the restructuring plan will result in the success of its strategy.

Certain aspects of BT Group's restructuring plans may require prior consultation with its regulators, the Secretary of State for Trade and Industry and the Director General of Telecommunications, who heads Oftel. Regulatory restrictions may impact the desirability of, or BT Group's ability to complete, the restructuring according to its existing plans.

BT Group cannot assure its shareholders that it will be successful in completing the restructuring as currently planned or that it will achieve all of its strategic goals. Failure in this regard could adversely affect its strategic and competitive position.

### **Competition in the UK fixed-network services**

BT Group continues to have a significant market share in some aspects of UK fixed-network services. In particular, approximately 83 per cent. of exchange lines in the United Kingdom were in the BT network as at 31 March 2001. Regulators are promoting competition in this area by allowing BT Group's competitors to site equipment in or adjacent to its exchanges (local loop unbundling) and to make it easier for BT Group's customers to route some or all of their calls over competitors' networks (carrier pre-selection). Reduction in BT Group's market share in the fixed-network may lead to a fall in BT Group's turnover and an adverse effect on profitability. Unlike its competitors, BT Group continues to be obliged by the current regulatory regime to serve customers in the United Kingdom, whether or not such provision of service is economic, and the two competitive measures described above may have the effect of accelerating the diversion of its more profitable existing customers without it being able to reduce its costs commensurately. These changes in the regulatory environment and ensuing increased competition on its fixed-network, may cause adverse effects on its business, results of operations, financial condition and prospects.

### **Technological changes**

BT Group operates in an industry with a recent history of fast technological changes. It expects that new products and technologies will emerge and that existing products and technologies will develop further. BT Group cannot predict the actual effect of these technological changes on its business or on its ability to provide competitive services. For example, presently there is evidence of substitution by customers using mobile phones for day-to-day voice calls, in place of making such calls over the fixed-network. Additionally, some calls are now being routed over the internet, in place of the traditional switched network. If these trends accelerate, BT Group's fixed-network assets may be used uneconomically and its investment in these assets may not be recovered through profits on fixed-network calls and line rentals. Impairment write-downs may be incurred and margins may decline if fixed costs cannot be reduced in line with falling turnover.

### **Forward-looking statements**

BT Group has targeted significant growth in new business areas. In view of the likely level of competition and uncertainties regarding the level of economic activity, there can be no certainty that BT Group will meet these growth targets, with a consequential impact on future turnover and profitability.

# Part 8: Information relating to the BT Group Share Schemes

Conditionally upon the Scheme and the Demerger becoming effective, BT Group will operate a range of share plans to encourage its employees to acquire BT Group Shares because the Board believes it is in the interests of BT Group for employees to be given the opportunity to own BT Group Shares. These comprise the BT Group All-Employee Share Schemes and the BT Group Executive Share Plans. All of these plans are substantially the same as those currently operated by BT, for which shareholder approval has already been obtained, where required.

## A. The BT Group All-Employee Share Schemes

### 1. Introduction

The BT Group All-Employee Share Schemes, which will be operated in the UK and are described in paragraphs 2, 3 and 4 below, comprise:

- (a) the BT Group Employee Share Investment Plan;
- (b) the BT Group Employee Share Ownership Scheme; and
- (c) the BT Group Employee Sharesave Scheme.

These will all be approved by the Inland Revenue, ensuring that BT Group takes advantage of favourable tax treatment for its employees as well as for BT Group itself.

The Board has also adopted arrangements for BT Group employees based outside the UK to enable them, wherever practicable, to qualify for tax-favoured treatment in their country of residence; these are described in paragraph 5 below.

It has been agreed by the Board that the following plans will be operated in the UK shortly after Admission, as follows:

- (a) BT Group Employee Share Investment Plan — UK employees will be entitled to commence monthly purchases of “partnership shares”, i.e. BT Group Shares at market value under the Employee Share Investment Plan, up to a limit of £125 per month; and
- (b) BT Group Employee Sharesave Scheme — employees will be entitled to apply for options under the Sharesave Scheme, on terms that they save for three or five years to finance the exercise price of the options (which will be set at a discount of 20 per cent. to the market value of a BT Group Share at a date shortly before the invitations to apply for options are issued).

### 2. The BT Group Employee Share Investment Plan

#### Eligibility

All eligible employees of the Company and participating subsidiaries who have been employed for a minimum period (not exceeding 12 months) are entitled to participate in the BT Group Employee Share Investment Plan (“the Plan”).

#### How the Plan may be operated

The Board can operate the Plan in a number of ways. It can:

- make an award of “free shares”; and/or
- give employees the opportunity to invest in “partnership shares”; and
- make an award of “matching shares” to those employees who have invested in “partnership shares” (free shares, partnership shares and matching shares — together “Plan Shares”); and/or
- require or allow employees to re-invest dividends paid on their Plan Shares in further BT Group Shares (“dividend shares”).

#### Free Shares

The Company may give free shares up to a maximum annual value set from time to time by the Inland Revenue. The current maximum annual value is £3,000 per employee. If the Company wishes, the award of free shares can be based on the achievement of personal, team, divisional or corporate performance targets which must be notified to all employees. Otherwise, free shares must be awarded to employees on the same terms, although awards can vary by reference to remuneration, length of service or hours worked.

#### Partnership Shares

The Company may provide employees with the opportunity to acquire partnership shares from their gross monthly salary, up to a maximum value set from time to time by the Inland Revenue, currently £125 per month. The Company may set a minimum monthly deduction which may not be greater than £10. BT Group Shares will be acquired on behalf of employees within 30 days after each

deduction at the market value of the shares on the date they are acquired. Alternatively, deductions can be accumulated for up to 12 months. In this case, BT Group Shares will be acquired on behalf of employees within 30 days after the end of the accumulation period, at the lower of the market value of the shares at the beginning of the accumulation period or the date when they are acquired.

### **Matching Shares**

The Company can give an employee up to two free matching shares for each partnership share acquired by the employee. The award of matching shares cannot be subject to performance targets.

### **Dividend Shares**

The Company can either give employees the opportunity or require employees to re-invest dividends paid on their Plan Shares in further BT Group Shares, up to a maximum amount which is currently set at £1,500 per annum.

### **Holding Period**

Free and/or matching shares must be held in trust for a period of not less than three years and not more than five years after the date on which the shares are allocated to employees.

Dividend shares must be held in trust for three years.

### **Cessation of employment, forfeiture of shares and non-transferability**

The Company can provide for free shares and/or matching shares to be forfeited if employees cease employment with BT Group (other than because of certain circumstances such as redundancy, injury or reaching retirement age) within the period of up to three years from the date on which shares were allocated.

Employees can withdraw their partnership shares from the Plan at any time. However, the Company can stipulate that matching shares will be subject to forfeiture if the corresponding partnership shares are withdrawn within a specified period, following their purchase on behalf of the employee, not exceeding three years.

Awards are not transferable except on death, when shares may be transferred to the deceased employee's personal representatives. Awards of shares under the Plan are not pensionable.

### **Funding the Plan**

If existing BT Group Shares are acquired as partnership shares, participating BT Group companies may be required to fund the acquisition cost to the extent that salary deductions are insufficient to do so.

### **Amendments to the Plan**

The Board will have authority to amend the Plan, provided that no amendment to the advantage of participants may be made to provisions relating to:

- who can participate;
- the individual and overall limits on participation;
- the basis for determining a participant's entitlement to Plan Shares and the terms on which they can be acquired; and
- any adjustment in the event of a variation in the Company's share capital,

without the prior approval of the shareholders in general meeting (unless the amendment is minor and made to benefit the administration of the Plan, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment).

## **3. The BT Group Employee Share Ownership Scheme**

Changes to tax legislation mean that awards of BT Group Shares under this scheme can only be made until 31 December 2002 and, unless there is a change in the law, it will therefore only be operated once.

The main provisions of the scheme are similar to those of the BT Group Employee Share Investment Plan relating to the allocation of free shares. Shares will be released from the Scheme after three years and will benefit from income tax relief. Shares awarded under the scheme are not forfeited if employees leave employment with BT Group prior to the third anniversary of the award.

## ***Part 8: Information relating to the BT Group Share Schemes***

### **4. The BT Group Employee Sharesave Scheme**

#### **General**

Under the Sharesave Scheme employees are granted an option to acquire BT Group Shares in the future at a price determined shortly before invitations to apply for the options are issued. The option price may be set at a discount to the market value of the share at that time. Employees are required to save monthly through a contractual savings arrangement over a period of either three years or five years. At the end of the savings period the employee may either exercise the option using the savings contributions and bonus or have the savings and bonus repaid.

#### **Eligibility**

All eligible employees of the Company and participating subsidiaries who have been employed for a minimum period (not exceeding five years) are entitled to participate in this scheme.

#### **Employee contributions**

The maximum amount an employee may save monthly over the three-year or five-year period is the maximum amount allowed under an Inland Revenue-approved savings-related share option scheme, which is currently £250 per month.

#### **Limits**

The maximum discount which may apply under the Sharesave Scheme is the maximum amount allowed under an Inland Revenue-approved savings-related share option scheme, which is currently 20 per cent. of the market value of the shares shortly before the option is granted.

#### **Leavers**

An employee who ceases to be an employee of the BT Group in certain circumstances (for example due to death, injury, disability, redundancy, retirement or following a change in control of the employing company or a takeover or winding up of the Company) may exercise the option within six months after ceasing to be an employee. If an employee ceases to be an employee of the BT Group for any other reason, the option lapses.

#### **Amendments to the Plan**

Please see the section headed “Amendments to the Plan” in paragraph 2 of this Part 8 above for the provisions regarding amendment of the BT Group Employee Sharesave Scheme.

### **5. The BT Group All-Employee Share Schemes outside the UK**

Under the BT Group International Employee Sharesave Scheme employees of the BT Group based outside the UK will be able to participate in similar arrangements to those described in paragraph 4 above, but with flexibility as regards the savings which may be arranged at a local level.

It has been agreed by the Board that there will also be an Employee Stock Purchase Plan for employees of BT Group's US subsidiaries (the “BT Group ESPP”). Details are described below.

#### **Eligibility**

All employees of participating subsidiaries will be eligible to participate on similar terms provided that they meet certain minimum employment requirements. Benefits under the BT Group ESPP are not pensionable.

#### **Grant of Purchase Rights**

The BT Group ESPP will enable employees to purchase BT Group ADSs at regular intervals, either monthly, quarterly or six monthly, at a price equal to the lower of (a) 85 per cent. of the average high and low trading prices of the ADSs on the New York Stock Exchange on the date on which purchase rights are granted, and (b) 85 per cent. of the average high and low trading prices of the ADSs on the date of purchase. The purchase rights are granted at the beginning of an ‘Offering Period’ which may be a period of up to 27 months. The offer must be made within 42 days after the announcement of quarterly, half year or annual results to the London Stock Exchange.

#### **Employee contributions**

To fund the acquisitions of the BT Group ADSs, participating employees can authorise the deduction of up to 15 per cent. of their salary for the whole of the Offering Period. No employee may purchase ADSs which exceed US\$25,000 in value in any calendar year.

### **Limits on issue of shares**

It is intended that both existing ADSs and ADSs created following the issue of new shares will be used to satisfy the exercise of purchase rights by employees. If newly-issued shares are used, this will be within the limits described in Section C of this Part 8.

The number of ADSs which will be made available for the purpose of awards under the BT Group ESPP will be limited to 4 million, representing 40 million BT Group Shares.

### **Leavers**

In the event of a participating employee's termination of employment for any reason, the employee's participation in the BT Group ESPP will terminate and no further deductions will be made from the employee's salary.

### **Amendments to the BT Group ESPP**

The provisions of the BT Group ESPP relating to:

- (a) the persons to whom or for whom benefits are provided under the BT Group ESPP;
- (b) the individual and scheme limits described above;
- (c) the basis for determining a participant's entitlement;
- (d) the terms of purchase rights under the BT Group ESPP; and
- (e) the adjustment of purchase rights in the event of a variation in the Company's share capital;

may not be altered to the advantage of participants without the prior approval of shareholders in general meeting (except minor amendments to benefit the administration of the BT Group ESPP, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants in the BT Group ESPP or for the Company or any participating subsidiary).

## **B. The BT Group Executive Share Plans**

### **1. Introduction**

The BT Group Equity Incentive Portfolio (the "Portfolio") comprises three elements: Incentive Shares; Retention Shares; and Share Options. These are described in paragraphs 2 to 5 below. The key drivers of the Portfolio are performance, flexibility and transparency. Different elements of the Portfolio will be operated as appropriate in individual circumstances.

The BT Group Deferred Bonus Plan is described in paragraph 6 below.

### **2. Incentive Shares**

#### **Nature of Awards**

Awards will be in respect of BT Group Shares and, subject to the exceptional circumstances referred to below, vesting of the awards will be contingent on the satisfaction of a specified performance target and continued employment with the BT Group.

#### **Incentive Period**

An award may not generally vest before the specified performance requirement has been met at the end of a period of time specified when the award is granted (the "Incentive Period"). The BT Group Remuneration Committee (the "Remuneration Committee") will set the Incentive Period, which will not be less than three years. The Remuneration Committee has discretion to provide that the vesting of a participant's award may be deferred, in whole or in part, even if the performance requirement has been met.

#### **Individual Limits**

The upper limit for individual awards will be set from time to time by the Remuneration Committee. BT Group anticipates the value of an award to be up to 200 per cent. of salary, with the vast majority of awards being below 100 per cent.

#### **Performance Target**

The Remuneration Committee will review the appropriateness of performance targets from time to time. However, any performance target which it chooses will be a corporate performance target which it believes to be demanding, relative to an appropriate benchmark. To encourage exceptional performance, the Remuneration Committee will have the discretion to reward performance within the upper

## ***Part 8: Information relating to the BT Group Share Schemes***

quartile, by increasing the number of BT Group Shares vesting by up to 100 per cent. This discretion will only be exercised if the Remuneration Committee is also satisfied that there has been a significant improvement in the Company's underlying financial performance.

If the Remuneration Committee decides to use the same performance target as BT the performance target for Incentive Shares will be total shareholder return ("TSR") measured over a period of not less than three years and compared with the other companies in the other FTSE 100. If BT Group's TSR reached median point, 25 per cent. of the award would vest, with the number of shares increasing on a straight line basis up to full vesting for upper quartile performance.

### **Rights attaching to BT Group Shares prior to the Vesting of Awards**

A participant has no rights in relation to the award or to the BT Group Shares which are the subject of the award until it has vested. The number of BT Group Shares under an award may, however, be increased during the Incentive Period by reinvesting dividends, or an amount equivalent to any dividends, paid on the BT Group Shares under the award.

### **Cessation of employment before the end of the Incentive Period**

If a participant ceases employment with the BT Group before the end of the Incentive Period, awards will generally lapse. However, if a participant dies or leaves on ill-health grounds and the Incentive Period will end less than 12 months after the participant ceases to be employed, the awards will vest immediately. If a participant ceases to be employed by the BT Group for any reason, however, the Company has discretion to vest or preserve to the end of the Incentive Period all or part of the awards.

### **Transfer of Shares at the end of the Incentive Period**

Once a participant's award has vested, BT Group Shares will be transferred to the participant as soon as practicable.

## **3. Retention Shares**

### **Nature of Awards**

Awards will be in respect of BT Group Shares and, subject to the exceptional circumstances referred to below, vesting of the awards will generally be contingent only on continued employment with BT Group. Awards may be granted subject also to the satisfaction of a specified performance target or other conditions such as the completion of specific projects, on vesting.

### **Retention Period and Individual Limits**

An award may not generally vest before the end of a period of time specified when the award is granted (the "Retention Period"). The Retention Period will normally be three years, but may be more or less, at the Remuneration Committee's discretion. As with Incentive Shares, the upper limit for individual awards will be set from time to time by the Remuneration Committee.

The following terms attaching to the Retention Shares and the Retention Period are the same as for the Incentive Shares and the Incentive Period (above):

- Rights attaching to Shares prior to the vesting of awards;
- Cessation of employment before the end of the Retention Period; and
- Transfer of Shares at the end of the Retention Period.

### **General Offer or Scheme of Arrangement**

If there is a change of control of BT Group and the acquiring company offers to roll over the awards into its shares, the awards will continue in accordance with the rules. If subsequently, before vesting, any participant is dismissed (other than for gross misconduct) or is demoted and leaves the company, the awards will vest on the date they leave.

If the acquiring company does not offer a rollover, the awards will vest on the change of control taking effect.

Please see paragraph 5 of Section B of this Part 8 for what happens to awards of Retention Shares which are subject to a performance target.

## **4. Share Options**

### **Nature of Awards**

Options to acquire BT Group Shares can either be Inland Revenue approved (for UK resident participants) or unapproved options. The terms which apply specifically to Inland Revenue approved options are contained in a separate section of the rules of the Portfolio.

### **Option Price**

The option price per BT Group Share will be not less than the market value of a share at the date of grant.

### **Performance**

The Remuneration Committee may make the exercise of an option subject to the satisfaction of a performance target, where that is appropriate in the relevant market, and for the circumstances in which the option is granted. Where the exercise of an option is not subject to the satisfaction of a performance target, its grant will be, except where individual recruitment circumstances dictate otherwise.

Circumstances where the Remuneration Committee would wish to have the flexibility not to impose a performance target on the exercise of an option are where competitive pressures on highly skilled, more junior employees, with proven high potential, are such that the Remuneration Committee believes it would not retain them if such options were not granted.

The exercise of options granted to senior executives would always be made subject to a performance target, except in exceptional circumstances such as recruitment.

### **Individual Limits**

The upper limit for levels of individual option awards will be set from time to time by the Remuneration Committee. The Remuneration Committee intends that individual option grants will generally be up to three times annual salary. The Remuneration Committee's policy will be to make grants of options on an annual basis.

### **Exercise Period**

An option may not generally be exercised before the end of a period of time specified when the option is granted. This exercise period will be set by the Remuneration Committee and will not be less than 12 months. An option may be granted on the basis that different exercise periods apply to specific numbers of BT Group Shares under that option.

### **Rights attaching to BT Group Shares prior to the exercise of options**

A participant has no rights in relation to an option nor to the BT Group Shares under the option until the option has been exercised.

### **Cessation of Employment**

If a participant ceases employment with the BT Group, all options will generally lapse on the date employment ceases, unless the participant ceases employment because of death or ill-health. In these circumstances, some or all of the options may be exercised after the participant leaves. The Company also has discretion to permit the exercise of options if a participant's employment ceases for any other reason.

### **General offer or scheme of arrangement**

If there is a change of control of BT Group and the acquiring company offers to roll over the options into options over its shares, the options will continue in accordance with the rules. If, subsequently, any participant is dismissed (other than for gross misconduct) or is demoted and leaves the Company, the options will become exercisable, if not already exercisable, on the date they leave and lapse after 12 months.

If the acquiring company does not offer a rollover, the options will become exercisable, if not already exercisable, on the change of control taking effect and will lapse after six months.

Please see paragraph 5 of Section B of this Part 8 for what happens to options which are subject to a performance target.

### **Lapse of options**

All options lapse on the tenth anniversary of their grant.

### **Provisions relating only to Inland Revenue approved options**

Inland Revenue approved options are those satisfying the requirements of Schedule 9 to the Income and Corporation Taxes Act 1988. Inland Revenue approved options are essentially subject to the same provisions as summarised above. The main differences relate to the following:

## **Part 8: Information relating to the BT Group Share Schemes**

- Individual limit: an employee cannot be granted an approved option which would, at the time it is granted, enable the employee to acquire shares under approved option schemes (which are not savings-related) exceeding the Inland Revenue limit from time to time, which is currently £30,000; and
- Inland Revenue approval: any amendment to the rules which affects the terms on which approved options may be granted or exercised requires the prior approval of the Inland Revenue. Any performance target must be objective.

### **Options granted to US employees**

The terms under which options are granted to employees who are US nationals or residents are essentially subject to the same provisions as summarised above, except that options may be over either shares or BT Group ADSs.

Options can be granted as Incentive Stock Options (“ISOs”) or Non Qualified Stock Options. If granted as ISOs, the exercise price cannot be less than the applicable market value of the shares or ADSs at the date of grant and the maximum market value of the shares or ADSs underlying all ISOs granted to a participant that become exercisable in a given year cannot exceed US\$100,000. The maximum number of shares which may be issued under ISOs is 30 million, representing 3 million ADSs, subject to adjustment in the event of an issue or reorganisation of the Company’s share capital.

## **5. Terms which apply to all of the Portfolio**

### **Who is eligible to participate**

The Remuneration Committee will have responsibility for agreeing any awards or options under the Portfolio to executive directors of BT Group and members of the senior executive team. It will also have responsibility for setting the policy for the way in which the Portfolio should be operated, including agreeing performance targets and how many employees should be invited to participate in the Portfolio. All employees of BT Group, including executive directors, and its subsidiaries are eligible to participate.

### **Nature of Awards**

Awards and options are not pensionable and may not be assigned or transferred except on a participant’s death, when they may be assigned to the participant’s personal representatives.

### **Grant of Awards**

Generally, awards can be granted at any time, but not during a close period of the Company. No payment is required for the grant of awards or options. All BT Group Shares allotted under the Portfolio will carry the same rights as all other issued ordinary shares in the Company and application will be made for the shares to be listed on the Official List and to be traded on the London Stock Exchange.

If there is a variation in the share capital of the Company (including a demerger or special dividend), the awards or options may be adjusted to reflect that variation.

### **General offer or Scheme of Arrangement — awards/options subject to a performance target**

If there is a change of control of BT Group, shares or options awarded subject to a performance target will vest or become exercisable on the change of control to the extent that the target has been met up to the date of the change of control. The Remuneration Committee will, in addition, have discretion, taking into account other factors it believes to be relevant, to increase the proportion of shares under award vesting, or the number of shares over which options will be exercisable, on a change of control. In certain circumstances, awards and options may be exchanged for equivalent rights in relation to an acquiring company’s shares.

If, within 12 months following the change of control, any participant is dismissed (other than for gross misconduct) or is demoted and leaves the company, they will receive the value of the balance of their award to the extent (if any) that it did not vest or did not become exercisable on the change of control.

### **Duration of the Portfolio**

No option or award may be granted more than ten years after the date of the EGM at which the Scheme and Demerger are approved by BT Shareholders.



### **Amending the rules of the Portfolio**

The Remuneration Committee will have authority to amend the rules of each element of the Portfolio, provided that no amendment to the advantage of participants may be made to provisions relating to:

- who can be a participant;
- the limits on the number of BT Group Shares which can be issued under the Portfolio;
- the basis for determining a participant's entitlement to BT Group Shares and the terms on which they can be acquired; and
- any adjustment in the event of a variation in the Company's share capital,

without the prior approval of shareholders in general meeting unless the amendment is minor and made to benefit the administration of the Portfolio, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment.

Additional schedules to the rules can be incorporated to operate one or more elements of the Portfolio outside the UK. These schedules can vary the rules of the Portfolio to take account of any securities, exchange control or taxation laws or regulations. The shares issued for these purposes will count towards the overall limit of shares issued under the Portfolio.

## **6. BT Group Deferred Bonus Plan**

### **Nature of Awards**

Under the Deferred Bonus Plan, awards in the form of BT Group Shares may be awarded to senior executives annually, in respect of their performance in the previous financial year. Awards will generally be equivalent in value to 50 per cent. of the executive's gross annual bonus (although this can vary up or down depending on individual performance). Only in exceptional circumstances would it exceed 100 per cent. The BT Group Shares are held in trust until the awards vest.

### **Deferred Period**

An award may not generally vest before the end of a period of time specified when the award is granted (the "Deferred Period"). The Remuneration Committee will set the Deferred Period which will not be less than three years.

Generally an award will be transferred to the executive if still employed by the BT Group in three years time. There are no additional performance measures for the vesting of Deferred Bonus Plan awards.

### **Rights attaching to BT Group Shares prior to the vesting of awards**

A participant has no rights in relation to the award or to the BT Group Shares which are the subject of the award until it has vested. The number of BT Group Shares under an award may, however, be increased during the Deferred Period by reinvesting dividends, or an amount equivalent to any dividends, paid on the BT Group Shares under the award.

### **Cessation of employment before the end of the Deferred Period**

If a participant ceases employment with the BT Group before the end of the Deferred Period, awards will generally lapse. However, if a participant ceases to be employed by the BT Group for any reason, the Company has discretion to vest or preserve to the end of the Deferred Period all or part of the awards.

### **Transfer of Shares at the end of the Deferred Period**

Once a participant's awards has vested, BT Group Shares will be transferred to the participant as soon as practicable.

### **Amending the Rules of the Plan**

The Remuneration Committee can amend the rules of the Deferred Bonus Plan at any time.

## **C. Limits on the Issue of BT Group Shares under the BT Group Share Schemes**

To the extent that newly-issued BT Group Shares are used, the BT Group Share Schemes will be subject to the limit that, in any ten-year period, the use of new issue shares is limited to 10 per cent. of BT Group's issued share capital for all BT Group Share Schemes (excluding the BT Group Legacy Option Plan described in Section D of this Part 8 below), of which not more than 5 per cent. can be used for those plans operated on a selective basis. Awards of Retention Shares and awards under the Deferred Bonus Plan will use existing shares only.

## ***Part 8: Information relating to the BT Group Share Schemes***

Where awards are granted over existing BT Group Shares, these will be held in a discretionary employee benefit trust established to facilitate the acquisition and holding of shares for employees and former employees of the BT Group. The trust will also have the facility to subscribe for new BT Group Shares within the limits referred to above. The trust will not in any event hold more than 5 per cent. of the Company's issued share capital.

### **D. Continued operation of BT Executive Option Plans – Legacy Option Plan**

The BT Remuneration Committee has determined that existing executive options (to the extent that they are not exercised and are released by the Optionholder in the specified period before the Scheme) will roll over into options over shares in the new, listed holding company of the Optionholders' employing company after the Demerger (or, in the case of former employees, the new holding company of the business in which they worked) (the Company or mmO<sub>2</sub> plc as the case may be).

To effect this, existing options which are released will be exchanged for replacement options under Legacy Option Plans adopted by the Company and mmO<sub>2</sub> plc. The terms of this exchange will ensure that the total amount payable on exercise, and any gain or loss arising had the option been exercised at the time of the exchange, is the same before and after the exchange. The rules of the Legacy Option Plan contain provisions mirroring those of each of the Executive Option Plans under which the options over ordinary shares were granted. The replacement options will be granted on the same terms, and shall be exercisable between the same dates, as the options for which they are exchanged.

## Part 9: Additional information

### 1. Incorporation and activities

- (a) The Company was incorporated and registered in England and Wales on 30 March 2001 under the Companies Act as a private limited company with the name Newgate Telecommunications Limited with registered number 4190816. By virtue of a special resolution dated 10 September 2001 its name was changed to BT Group plc and it was re-registered as a public limited company.
- (b) The registered office of the Company is 81 Newgate Street, London EC1A 7AJ.
- (c) The Company has not traded since incorporation.
- (d) By a resolution of the directors of the Company dated 4 April 2001, PricewaterhouseCoopers, Chartered Accountants, whose address is 1 Embankment Place, London WC2N 6RH, were appointed as the first auditors of BT Group.
- (e) After the Demerger Effective Time, the Company will be the parent company of BT Group, one of Europe's leading communications companies, offering voice, broadband, data, and internet services across a number of lines of business, as described in Part 1 of this document.

### 2. Share capital

On incorporation, the authorised share capital of the Company was £100 divided into 100 ordinary shares of £1 each of which two ordinary shares were allotted and paid on incorporation. On 10 September 2001, a further 44 ordinary shares of £1 each were allotted and issued, and the authorised share capital was increased to £23,000,050,025 by the creation of 22,999,999,900 further ordinary shares and one redeemable preference share of £50,025. By an ordinary resolution of the shareholders dated 10 September 2001, the 23,000,000,000 ordinary shares of £1 each were consolidated and subdivided into 20,000,000,000 ordinary shares of 115 pence each. The redeemable preference share was allotted and treated as paid up in full on 10 September 2001. No application is being made to list the redeemable preference share.

The redeemable preference share carries no right to vote and carries the right to receive dividends at the cumulative fixed rate of 0.04 per cent. of its nominal value per annum but no other right to participate in the profits of the Company.

On 17 September 2001, the latest practicable date prior to the publication of this document, the authorised and issued share capital of the Company was as follows:

Number	Authorised			Issued	
	Number	Amount		Number	Amount
20,000,000,000	£23,000,000,000		40	£46	
1	£50,025	redeemable preference share	1	£50,025	

Alan Scott and David Borthwick are employees of BT and are the initial shareholders of the Company. Alan Scott holds 20 ordinary shares. David Borthwick holds 20 ordinary shares. Jeffery Fisher, who is also an employee of BT, holds the redeemable preference share.

By special resolutions passed on 10 September 2001, it was resolved that:

- (a) upon redemption in full of the one redeemable preference share in the share capital of the Company, the BT Group Articles be amended by deleting the terms relating to the redeemable preference share;
- (b) the Company be generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Act) of BT Group Shares provided that:
  - (i) the minimum price that may be paid for any BT Group Share is 115 pence (or such higher amount as may be required by law) and the maximum price that may be paid for any BT Group Share is an amount equal to 105 per cent. of the average of the middle market quotations for such share as is derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the BT Group Share is contracted to be purchased; and
  - (ii) the maximum number of BT Group Shares that may be acquired under that authority is 870,000,000 (representing approximately 10 per cent. of the issued ordinary share capital of the Company expected to be in issue upon the Demerger becoming effective), such authority to expire on 10 September 2002 or at the conclusion of the annual general meeting of the Company in 2002, whichever is earlier, except that the Company may before such expiry enter into a contract to purchase such shares which would or might be executed wholly or partly after such expiry; and

## Part 9: Additional information

- (c) subject to and conditional upon the BT Group Shares required to be issued by the Company pursuant to the Demerger having been registered in the names of the persons thereto:
- (i) the capital of the Company be reduced by:
- (a) cancelling paid up capital to the extent of 110 pence on each of the BT Group Shares in issue at the close of business on the day immediately preceding the date (the “Order Date”) on which an order is made confirming the BT Group Reduction of Capital or, if later, the date on which such order is expressed to take effect; and
- (b) reducing the nominal amount of each of the BT Group Shares referred to in paragraph (a) above from 115 pence to 5 pence; and
- (ii) forthwith upon the reduction of capital taking effect each of the BT Group Shares which are authorised but unissued at the close of business on the day immediately preceding the Order Date be sub-divided into 23 BT Group Shares of 5 pence each.

On the Demerger becoming effective assuming that no further BT Shares have been issued or repurchased after 17 September 2001, the latest practicable date prior to the publication of this document, in accordance with the exercise of rights granted under the BT Schemes, the authorised and issued share capital of the Company is expected to be as follows:

Number	Authorised			Issued	
	Number	Amount		Number	Amount
20,000,000,000	£23,000,000,000		ordinary shares	8,599,475,668	£9,889,397,018.20
1	£50,025		redeemable preference share	1	£50,025

Under the BT Group Articles, a new authority and power to allot shares is being given to the directors of the Company. The authorised share capital of the Company will be £23,000,050,025. The directors of the Company will be authorised generally under section 80 of the Companies Act to allot shares or rights to subscribe or to convert any security into shares with an aggregate nominal value equal to the section 80 amount, as defined in the BT Group Articles. By an ordinary resolution dated 10 September 2001, the section 80 amount was set at £13,455,050,025. This authority will end on the date of BT Group’s Annual General Meeting in 2002 or, if earlier, on 10 December 2002. The authority to allot shares or rights to shares under section 80 of the Companies Act has been calculated on the basis that the directors of the Company will require sufficient authorised share capital and authority to cover the aggregate of (1) the BT Group initial allotment of approximately 8.7 billion BT Group Shares upon the Demerger becoming effective (based on the BT Shares in issue as at 10 September 2001 (the date the BT Group Articles were adopted) and the Directors’ estimate of the maximum number of BT Shares that may be required to be issued on or before the Scheme Reduction Time in connection with the exercise of options under the BT Option Schemes and the operation of the special purpose trust (as described in paragraph 1 of Part 2 of this document), (2) the allotment of one redeemable preference share of £50,025, and (3) an amount equal to approximately 33 per cent. of the expected issued ordinary share capital of BT Group immediately after the allotment of the BT Group Shares pursuant to the Demerger referred to in (1) above.

The directors are also being empowered under the BT Group Articles to allot equity securities (within the meaning of section 94 of the Companies Act) for cash, where they have the general authority under section 80 referred to above, as if section 89(1) of the Companies Act did not apply to it. There is no limit on the maximum amount of equity securities which can be allotted under this power where the allotment is in connection with a rights issue (as defined in the BT Group Articles). In all other cases, the maximum nominal amount of equity securities which can be allotted under this power is the section 89 amount. By a special resolution dated 10 September 2001, the section 89 amount was set at £500,130,000 (being approximately 5 per cent. of the expected issued share capital of the Company assuming approximately 8.7 billion BT Group Shares are allotted and issued upon the Demerger being implemented) for a period ending on the date of BT Group’s Annual General Meeting in 2002 or, if earlier, on 10 December 2002.

During the periods referred to above, the BT Group directors can make offers and enter into agreements which would, or might, require shares to be allotted after these periods. Each of the authorities referred to in the two preceding paragraphs can be extended or renewed by shareholder approval (by an ordinary resolution in the case of the section 80 authority and by a special resolution in the case of the section 89 authority).

### **3. Memorandum and Articles of Association**

The memorandum of association of the Company provides that its principal objects are, among other things, to carry on any business of running, operating, managing and supplying telecommunication systems and systems of any kind for conveying, receiving, storing, processing or transmitting sounds, visual images, signals, messages and communications of any kind. The objects of the Company are set out in full in clause 4 of the Company's memorandum of association, which is available for inspection at the addresses specified in paragraph 18 of this Part 9.

The following is a summary of the rights under the BT Group Articles relating to voting, dividends and transfers which attach to the BT Group Shares.

In the following description of the rights attaching to the BT Group Shares, a "holder of shares" and a "shareholder" is, in either case, the person on the Company's register of members as the holder of the relevant shares. BT Group Shareholders can choose whether their shares are to be evidenced by share certificates (i.e. in certificated form) or held in electronic (i.e. uncertificated) form in CREST.

#### ***(a) Voting rights***

Subject to the restrictions described below, on a show of hands every holder of BT Group Shares who is present in person or by proxy at any general meeting shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote for each share which they hold.

Voting at any meeting of shareholders is by a show of hands unless a poll is demanded by the chairman of the meeting or by at least five shareholders at the meeting who are entitled to vote (or their proxies), or by one or more shareholders at the meeting who are entitled to vote (or their proxies) and who have, between them, at least 10 per cent. of the total votes of all shareholders who have the right to vote at the meeting.

A shareholder whose registered address is outside the UK and who wishes to receive notices of meetings of shareholders must give the Company an address within the UK to which they may be sent.

No person shall, unless the board otherwise determines, be entitled to attend or vote at any general meeting or to exercise any other right conferred by being a shareholder if he or any person appearing to be interested in those shares has been sent a notice under section 212 of the Companies Act (which confers upon public companies the power to require information with respect to interests in their voting shares) and he or any such interested person has failed to supply to the Company the information requested within 14 days after delivery of that notice. These restrictions end (unless the board decides otherwise) seven days after the earlier of the date the shareholder complies with the request satisfactorily or the Company receives notice that there has been an approved transfer of the shares.

#### ***(b) Variation of rights***

Whenever the share capital of the Company is split into different classes of shares, the special rights attached to any of those classes can be varied or withdrawn either:

- (i) with the sanction of any extraordinary resolution passed at a separate meeting of the holders of the shares of that class; or
- (ii) with the consent in writing of the holders of at least 75 per cent. in nominal value of the issued shares of that class.

At any separate meeting, the necessary quorum is two persons holding or representing by proxy not less than one-third in nominal amount of the issued shares of the class in question (but at any adjourned meeting, any person holding shares of the class or his proxy is a quorum).

The Company can issue new shares and attach any rights and restrictions to them, as long as this is not restricted by special rights previously given to holders of any existing shares. Subject to this, the rights of new shares can take priority over the rights of existing shares, or existing shares can take priority over them, or the new shares and the existing shares can rank equally.

#### ***(c) Changes in capital***

The Company may by ordinary resolution:

- (i) consolidate and divide all or any of its share capital into shares of a larger amount;
- (ii) divide all or part of its share capital into shares of a smaller amount;

## **Part 9: Additional information**

(iii) cancel any shares which have not, at the date of the ordinary resolution, been taken or agreed to be taken by any person and reduce the amount of its share capital by the amount of the shares cancelled; and

(iv) increase its share capital.

The Company may also:

(i) buy back its own shares; and

(ii) by special resolution reduce its share capital, any capital redemption reserve and any share premium account.

### **(d) Dividends**

The Company's shareholders can declare dividends by passing an ordinary resolution provided that no dividend can exceed the amount recommended by the directors. Dividends must be paid out of profits available for distribution. If the directors consider that the profits of the Company justify such payments, they can pay interim dividends on any class of shares of the amounts on the dates and for the periods they decide. Fixed dividends will be paid on any class of share on the dates stated for the payments of those dividends.

The directors can offer ordinary shareholders the right to choose to receive new ordinary shares, which are credited as fully paid, instead of some or all of their cash dividend. Before they can do this, the Company's shareholders must have passed an ordinary resolution authorising the directors to make this offer.

Any dividend which has not been claimed for 10 years after it was declared or became due for payment will be forfeited and will belong to the Company unless the directors decide otherwise.

### **(e) Distribution of assets on winding up**

If the Company is wound up (whether the liquidation is voluntary, under supervision of a court or by a court) the liquidator can, with the authority of an extraordinary resolution passed by the shareholders, divide among the shareholders all or any part of the assets of the Company. This applies whether the assets consist of property of one kind or different kinds. For this purpose, the liquidator can place whatever value the liquidator considers fair on any property and decide how the division is carried out between shareholders or different groups of shareholders. The liquidator can also, with the same authority, transfer any assets to trustees upon any trusts for the benefit of shareholders which the liquidator decides. The liquidation of the Company can then be finalised and the Company dissolved. No past or present shareholder can be compelled to accept any shares or other property under the BT Group Articles which could give them a liability.

### **(f) Transfer of shares**

Certificated shares of the Company may be transferred in writing either by an instrument of transfer in the usual standard form or in such other form approved by the board. The transfer form must be signed or made effective by or on behalf of the person making the transfer. The person making the transfer will be treated as continuing to be the holder of the shares transferred until the name of the person to whom the shares are being transferred is entered in the register of members of the Company.

The board may refuse to register any transfer of any share held in certificated form:

- which is in favour of more than four joint holders; or
- unless the transfer form to be registered is properly stamped to show payment of any applicable stamp duty and delivered to the Company's registered office or any other place the board decides. The transfer must have with it the share certificate for the shares to be transferred; any other evidence which the board asks for to prove that the person wanting to make the transfer is entitled to do this; and if the transfer form is executed by another person on behalf of the person making the transfer, evidence of the authority of that person to do so.

Transfers of uncertificated shares must be carried out using a relevant system (as defined in the Regulations). The board can refuse to register a transfer of an uncertificated share in the circumstances stated in the Regulations.

If the board decides not to register a transfer of a share, it must notify the person to whom that share was to be transferred no later than two months after the Company receives the transfer form or instruction from the operator of the relevant system.

### **(g) Directors' votes**

Unless the BT Group Articles say otherwise, a director cannot vote on a resolution about a contract in which the director has a material interest (this will also apply to interests of a person connected with the director). The director can vote if the interest is only an interest

in BT Group Shares, debentures or other securities. A director can, however, vote and be counted in a quorum in respect of certain matters in which he is interested as set out in the BT Group Articles.

Subject to the relevant legislation, the shareholders can by passing an ordinary resolution suspend or relax, among other things, the provisions relating to the declaration of the interest of a director in any contract or arrangement or relating to a director's right to vote and be counted in a quorum on resolutions in which he is interested to any extent or ratify any particular contract or arrangement carried out in breach of those provisions.

*(h) Directors' remuneration*

Excluding remuneration referred to below, each director shall be paid such fees for his services as the board decides, not exceeding £50,000 a year and increasing by the percentage increase of the retail prices index (as defined by Section 833(2) Income and Corporation Taxes Act 1988) for any 12 month period beginning 1 April 1999 or an anniversary of that date. The Company may by ordinary resolution decide on a higher sum. This resolution can increase the fee paid to all or any directors either permanently or for a particular period. The directors may be paid their expenses properly incurred in connection with the business of the Company.

The board can award extra remuneration to a director who holds an executive position; acts as chairman or deputy chairman; serves on a board committee at the request of the board; or performs any other services which the board consider extends beyond the ordinary duties of a director.

The directors may grant pensions or other benefits to, among others, any director or former director or persons connected with them. However, BT Group can only provide such benefits to any director or former director who has not been an employee, or held any other office or executive position in the Company or any of its subsidiary undertakings, or to relations or dependants of, or people connected to, those directors or former directors, if the shareholders approve this by passing an ordinary resolution.

*(i) Retirement of directors*

Provisions of the legislation which, read with the BT Group Articles, would restrict the appointment of a director or require him to stop being a director because he has reached a particular age do not apply to the Company.

At every annual general meeting, any director who was elected or last re-elected a director at or before the annual general meeting in the third year before the current year, shall retire by rotation. Any director appointed by the directors automatically retires at the next following annual general meeting. A retiring director is eligible for re-election.

*(j) Directors' borrowing powers*

Under the BT Group Articles, the Board must limit the borrowings of the Company and its voting and other rights or powers of control exercisable by the Company in relation to its subsidiary undertaking so as to ensure that the aggregate amount of all borrowings by the BT Group outstanding, net of cash and short-term investments maturing within three months, at any time does not exceed £35 billion.

## Part 9: Additional information

### 4. Directors of BT Group

The details of those companies and partnerships outside the BT Group of which the Directors are currently directors, or have been directors or partners at any time during the previous five years prior to the date of this document, are as follows:

Name of Director	Current directorships and partnerships	Previous directorships and partnerships
Sir Christopher Bland	British Broadcasting Corporation Leiths School of Food and Wine Limited Playford Productions Limited foodndrink.co.uk Limited	NFC plc Life Sciences International Limited Royal Postgraduate Trust Limited (Dissolved 18 May 1999) The Private Finance Panel Limited
Sir Peter Bonfield	AstraZeneca plc British Quality Foundation	MCI Communications Corporation ICL PLC
Philip Hampton	—	BG Group plc British Gas plc Seabank Power Limited
Sir Anthony Greener	Ufi Charitable Trust Ufi Limited Robert Mondavi Corporation	Diageo plc Grand Metropolitan plc Guinness Limited Reed Elsevier Plc Reed International plc The Marketing Council United Distillers & Vintners (ER) Limited
Helen Alexander	Northern Foods plc The Economist Newspaper Limited Writers & Scholars International Limited Tate Foundation Periodical Publishers Association Limited	—
Louis Hughes	AB Electrolux Maxager Technology Inc. Sulzer AG	Deutsche Bank Lockheed Martin Corporation
Neville Isdell	Coca Cola HBC	Amalgamated Beverages Great Britain Limited Coca Cola Beverages plc
June de Moller	Aldeburgh Productions 35 Cadogan Square Management Limited Cookson Group Plc Eastern Counties Newspaper Group Limited J Sainsbury plc Lynx Group Plc The Home of Rest for Horses	Anglian Water Plc Carlton Communications plc Independent Television News Limited
Maarten van den Bergh	Lloyds TSB Group plc Lloyds TSB Bank plc Royal Dutch Petroleum Company Shell Petroleum Company Limited Shell Petroleum NV	Anglo Coal Marketing Limited Anglo Coal Holdings Limited
Sir John Weston	Hakluyt & Company Limited Rolls-Royce plc	—

From 16 to 19 November 2001, for technical reasons relating to the procedures for the Scheme and the Demerger, Sir Christopher Bland, Sir Peter Bonfield and Philip Hampton will also be directors of mmO<sub>2</sub> plc.



At the date of this document none of the Directors:

- (a) has any unspent convictions in relation to any indictable offences;
- (b) has been bankrupt or entered into an individual voluntary arrangement;
- (c) was a director with an executive function of any company at the time of or within 12 months preceding any receivership, compulsory liquidation, creditors voluntary liquidation, administration, company voluntary arrangement or any composition or arrangement with that company's creditors generally or with any class of its creditors;
- (d) has been a partner in a partnership at the time of or within 12 months preceding any compulsory liquidation, administration or partnership voluntary arrangement of such partnership;
- (e) has had his assets the subject of any receivership or has been a partner of a partnership at the time of or within 12 months preceding any assets thereof being the subject of a receivership; nor
- (f) has been subject to any public criticism by any statutory or regulatory authority (including any recognised professional body) nor has ever been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of a company.

#### 5. Directors' and others' interests

On Demerger, assuming that no further BT Shares have been issued or repurchased after 17 September 2001, the latest practicable date prior to the publication of this document, in accordance with the exercise of rights granted under the BT Share Schemes, the interests of the Directors (and persons connected with them within the meaning of section 346 of the Companies Act) in the share capital of the Company (a) which are required to be notified by each Director to the Company pursuant to section 324 or section 328 of the Companies Act or (b) are required to be entered in the register referred to in section 325 of the Companies Act or (c) are interests of a connected person of a Director which would, if the connected person were a Director, be required to be disclosed under (a) or (b), and the existence of which is known, or which could, with reasonable diligence, be ascertained by that Director, will be as follows:

##### (a) Interests in BT Group Shares

Name of Director	Number of BT Group Shares
Sir Christopher Bland	286,000
Sir Peter Bonfield	21,883 <sup>(1)</sup>
Philip R Hampton	1,014
Sir Anthony Greener	11,615
Helen Alexander	3,500
Maarten van den Bergh	2,800
Louis R Hughes	6,800
Neville Isdell	29,750
June de Moller	2,800
Sir John Weston	1,379

In aggregate, the Directors' interests in BT Group Shares will amount to approximately 0.004 per cent. of the Company's issued share capital.

*Note:*

- (1) Includes 12,487 BT Group Shares held by Ilford Trustees (Jersey) Limited.

## Part 9: Additional information

### (b) Interests under the BT Share Schemes

Details of interests in BT share awards over Shares held under the BT Share Schemes referred to below at 17 September 2001 (the latest practicable date prior to the publication of this document) are as follows:

	ESP	DBP	ISP	RSP	Total
Sir Christopher Bland	—	—	235,697	—	235,697
Sir Peter Bonfield	438,033	317,012	588,652	—	1,343,697
Philip Hampton	—	11,784	153,792	60,189	225,765

Key:

ESP = BT Executive Share Plan

DBP = BT Deferred Bonus Plan

ISP = BT Incentive Share Plan

RSP = BT Retention Share Plan

These awards will, subject to vesting, be satisfied in BT Group Shares only, following an adjustment to take account of the Scheme and the Demerger. It is not currently possible to provide details of the Directors' interests in BT Group Shares which will exist following the Demerger because the terms of the adjustment referred to above cannot be established until after Admission.

- (c) In accordance with the terms of his service contract, Sir Christopher Bland purchased shares to the value of £1 million on 15 May 2001 and on 22 June 2001 an option over 238,100 shares with an exercise price of 420p per share under the BT Global Share Option Plan was granted to him. This option is normally exercisable between May 2004 and June 2011. This option will be exchanged for a replacement option over BT Group Shares. It is not currently possible to state the number of BT Group Shares and the exercise price under the new option, as the revised terms cannot be established until after Admission.

None of the other Directors hold options, or exercised options during the year, under the BT Option Schemes.

- (d) Save as disclosed above, none of the Directors (nor any person connected with them) will have a beneficial or non-beneficial interest in the share capital of BT Group plc. Save as disclosed above, none of the Directors (nor any person connected with them) holds an interest in any other securities of the Company.
- (e) No Director has or has had any interests in any transaction which is or was unusual in its nature or conditions or is or was significant to the business of the BT Group or the Company and which was effected by the BT Group in the current or immediately preceding financial year of the BT Group or which was effected during an earlier financial year and remains in any respect outstanding or unperformed.
- (f) It is estimated that under arrangements in force as at the date of this document, the aggregate remuneration to be paid and benefits in kind to be granted to the Directors by the BT Group for the year ending 31 March 2002 will be approximately £3,605,000.
- (g) The aggregate of the remuneration paid and benefits in kind granted to the Directors by any member of the BT Group in respect of the year ended 31 March 2001 was approximately £2,000,000 including benefits from car schemes, loans and health insurance arrangements.
- (h) There are no outstanding loans granted by the Company or any member of the BT Group to any Director nor any guarantees provided by any member of the BT Group for the benefit of any Director.
- (i) None of the Directors has waived or agreed to waive any future emoluments during the past financial year.
- (j) The Company is not aware of any persons who as at the date of this document could directly or indirectly, jointly or severally, exercise control over the Company.
- (k) As at 17 September 2001, the latest practicable date prior to the publication of this document, the Company is not aware of any person who is or, immediately following Admission, will be interested (within the meaning of the Companies Act), directly or indirectly, in three per cent. or more of the issued share capital of the Company.

## 6. Directors' service agreements and terms of appointment

The remuneration (including salary and other benefits) payable under the Chairman's and Executive Directors' service contracts are as follows:

Chairman and Executive Directors	Salary and fees £000s	Other benefits <sup>(a)(b)</sup> £000s
Sir Francis Christopher Buchan Bland	500	50
Sir Peter Leahy Bonfield <sup>(c)</sup>	820	50
Philip Roy Hampton	435	50

### Notes:

- (a) Estimated value for financial year ending 31 March 2002 of contractual benefits (excluding pension), comprising car allowance, healthcare, telecommunications facilities and professional subscriptions and advice. In addition the Chairman and the Executive Directors participate in pension arrangements.
- (b) Sir Peter Bonfield and Philip Hampton may be paid a bonus at the discretion of the board and at the discretion of the board may participate in any scheme established for BT Group employees to acquire shares in BT Group.
- (c) Sir Peter Bonfield's contract contains an entitlement to receive an award in 2001 of 200 per cent. of salary under BT's Incentive Share Plan and 100 per cent. of bonus (£481,000) under BT's Deferred Bonus Plan. If the contract is in effect on 31 December 2002, Sir Peter Bonfield will be paid a terminal bonus of £820,000 as an incentive to oversee the restructuring of the Group, in addition to his on-target annual bonus and additional pensionable service of one year and he will be entitled to have all share awards preserved subject to performance targets being met.

The dates on which the Chairman's and each current Executive Director's initial service agreement commenced and the current expiry dates are as follows:

Chairman and Executive Directors	Commencement date of initial service contract	Expiry date of current service contract
Sir Christopher Bland	1 May 2001	(a)
Sir Peter Bonfield	1 January 1996	31 December 2002 <sup>(b)</sup>
Philip Hampton	1 November 2000	31 October 2002 <sup>(c)</sup>

### Notes:

- (a) Sir Christopher Bland's contract is terminable on 12 months' notice by either the Company or the Director.
- (b) Sir Peter Bonfield entered into a new contract on 4 May 2001, which continues to 31 December 2002, terminable earlier by the Company on payment of 12 months' compensation or on six months' notice by the Director. It may continue after that date if both the Company and the Director agree. If BT terminates Sir Peter Bonfield's contract within one year of BT becoming a subsidiary of another company, other than in pursuance of a scheme of arrangement or if the ultimate holding company would have substantially the same shareholders as those of BT immediately prior to the relevant events, then BT will pay: the total of the current year's on-target bonus or the previous year's bonus (whichever is the higher); the market value of all shares awarded under any share ownership plan or deferred bonus plan which have not vested at the date of termination; and 12 months' salary and benefits.
- (c) Philip Hampton entered into a contract commencing on 1 November 2000 for an initial period of two years. The contract is terminable on 12 months' notice ending at any time after 31 October 2002 by either the Company or the Director. If BT terminates Philip Hampton's contract within one year of BT entering into a scheme of arrangement or becoming a subsidiary of another company, then BT will pay: the total of the current year's on-target bonus or the previous year's bonus (whichever is the higher); the market value of all shares awarded under any share ownership plan or deferred bonus plan which have not vested at the date of termination; and 12 months' salary and benefits.
- (d) BT has the discretion to pay Sir Christopher Bland, Sir Peter Bonfield and Philip Hampton 12 months' salary and benefits in lieu of notice.

### Non-Executive Directors

The date of expiry of the current term of appointment for each of the non-executive Directors and their current fees are as follows:

Name of Non-Executive Director	Date of expiry of current term of appointment <sup>(a)</sup>	Total fees and other benefits payable
Sir Anthony Armitage Greener	30 September 2003	£90,000
Helen Alexander	31 May 2002	£35,000
Maarten Albert van den Bergh	31 August 2003	£40,000
Louis Ralph Hughes	31 December 2002	£37,000
Edward Neville Isdell	30 June 2002	£40,000
June Frances de Moller	31 August 2002	£35,000
Sir Philip John Weston	30 September 2002	£38,000

### Notes:

- (a) Each Director's contract of appointment is for an initial period of three years. After that period the contract is terminable on 12 months' notice by either the Company or the director.
- (b) In addition, in the current financial year, Neville Isdell received £65,000 in fees from Yell.

If the Scheme is approved, it is proposed that Sir Christopher Bland, Sir Peter Bonfield and Philip Hampton will enter into new service contracts with the Company commencing on the Demerger Effective Date. Such service contracts will supersede the existing arrangements with BT, which will terminate without compensation. The new contracts will be upon the same terms as the

## ***Part 9: Additional information***

current service contracts with BT save that BT will pay, in monthly instalments, to Sir Christopher Bland's personal pension plan 10 per cent. per year of his salary up to the limit of Sir Christopher Bland's pension earnings cap which for the current financial year is £9,540;

Save as disclosed above, there will be no variation in the total emoluments receivable by the directors of the Company as a result of the Proposals.

### **7. Parent and subsidiary undertakings of BT Group plc**

At the date of this document, the Company is owned by Alan Scott, David Borthwick and Jeffery Fisher, all of whom are existing employees of BT and who hold shares in the Company for the purposes of its incorporation as further described in paragraphs 1 and 2 of this Part 9 above.

On the Demerger becoming effective, the following principal subsidiaries will be wholly-owned (directly or indirectly) by the Company:

Name <sup>(a)</sup>	Activity	Registered Office
<b>Subsidiary undertakings</b>		
Autumnwindow Limited	Property holding company	81 Newgate Street, London EC1A 7AJ
British Telecommunications public limited company	Communication related services and products provider and holding company	81 Newgate Street, London EC1A 7AJ
BT Australasia Pty Limited <sup>(c)</sup>	Communication related services and products provider	Level 12, BT Tower, 1 Market Street, Sydney, NSW 2000, Australia
BT Cableships Limited <sup>(c)</sup>	Cableship owner	81 Newgate Street, London EC1A 7AJ
BT Communications Management Limited <sup>(c)</sup>	Telecommunication services provider	81 Newgate Street, London EC1A 7AJ
BT Group Investments	Intermediate Holding Co.	81 Newgate Street, London EC1A 7AJ
BT (Hong Kong) Limited <sup>(c)</sup>	Communication related services and products provider	Suite 1301, Two Pacific Place, 88 Queensway, Central, Hong Kong
BT Ignite GmbH <sup>(c)</sup>	Data services provider	Georg-Brauchle Ring 23-25, Munich, D-80992, Germany
BT Ignite GmbH & Co <sup>(c)</sup>	Communication related services and products provider	Elsenheimer Strasse 11, 80687, Munich, Germany
BT Ignite Nederland BV <sup>(c)</sup>	Communication related services and products provider	Atlas Kantorencentrum Amerika Building, Hoogoordarent 15,1101 8A, Amsterdam, The Netherlands
BT North America Inc <sup>(c)</sup>	Communication related services and products provider	40 East 52nd Street, New York, NY 10022, United States of America
BT Property Limited <sup>(c)</sup>	Property holding company	81 Newgate Street, London EC1A 7AJ
BT Subsea Cables Limited	Cable maintenance and repair	81 Newgate Street, London EC1A 7AJ
BT Telecomunicaciones SA <sup>(c)</sup>	Communication related services and products provider	Edificio Herre, Salvadore De Madariago, 1, Madrid, 28027, Spain
BT (Worldwide) Limited <sup>(c)</sup>	International telecommunication network systems provider	81 Newgate Street, London EC1A 7AJ
Clear Communications Limited <sup>(c)</sup>	Communication related services and products provider	11th Floor, Clear Tower, 49 Symonds Street, Auckland, New Zealand
Esat Group Limited <sup>(c)</sup>	Telecommunications services provider	Grand Canal Quay, Dublin 2, Republic of Ireland
Farland BV <sup>(b)(c)</sup>	Provider of trans-border fibre network across BT's partners in Europe	Overschiestraat 65, 1062XD , Amsterdam, Netherlands
Inet	Computer systems services	Via Caldera 21/C, Milan, Italy
Syntegra Groep BV <sup>(c)</sup>	Systems integrations and application development	Louis Braillelaan 6, 2719EJ Zoetemeer, Postbus 552, 2700 AN Zoetmeer, Netherlands
Syntegra SA <sup>(c)</sup>	Systems integration and application development	Immeuble Lavoisier, 4 Place des Vosges, Cedex 64, Paris la Defense, 92052, France
Syntegra (USA) <sup>(b)(c)</sup>	Systems integration and electronic business outsourcing services	1209 Orange Street, Wilmington, Delaware 19801, United States of America

**Notes:**

- (a) This list only includes those companies that have a more significant impact on the profit or assets of BT Group.
- (b) All overseas undertakings are incorporated in the country in which their registered office is situated.
- (c) Held through intermediate holding company.

## Part 9: Additional information

### 8. Significant shareholdings

Prior to the Demerger, Alan Scott and David Borthwick will each hold 20 BT Group Shares and Jeffery Fisher will hold one redeemable preference share in the issued share capital of BT Group. All are existing employees of BT and hold shares in BT Group plc for the purposes of its incorporation as described in paragraphs 1 and 2 of this Part 9 above.

Upon the Demerger becoming effective, on the basis of the information available to them as at 17 September 2001 (the latest practicable date prior to the publication of this document), the Directors are not aware of any interests, held directly or indirectly, in the issued share capital of BT Group which will amount to three per cent. or more of BT Group's then issued share capital.

### 9. Principal establishments

The BT Group's principal establishments which are occupied by the Company and/or its subsidiaries are:

Address	Current use	Tenure and unexpired term	Annual Rental	Approximate area (sq ft)
81 Newgate Street London EC1A 7AJ	Head Office	Freehold	—	280,000
120 Holborn London EC1N 2TE	Administration	Lease to 25 March 2014	£6,500,000	177,000

### 10. Pensions

The Demerger will not impact on the existing pension arrangements under the BT Pension Scheme, the BT Retirement Plan and other supplementary schemes for employees in BT Group. Whilst some technical rule changes to the BT pension schemes rules will be required in order to align the new corporate structure, this will not materially affect employees.

There are currently approximately 7,500 employees in mmO<sub>2</sub> who are members of the BT pension schemes and, following the Demerger, mmO<sub>2</sub> will establish its own pension arrangements for these people. It is however likely to continue to participate in the BT pension schemes for a period of up to 12 months post demerger whilst the alternative arrangements are put in place. Employees will be offered the option of transferring their past service benefits to the new arrangements on bulk terms.

### 11. Significant change

Save as disclosed in the paragraph headed "Recent developments" in Part 1 of this document, there has been no significant change in the financial or trading position of the BT Group since 30 June 2001, being the date to which BT prepared its last quarterly interim statement.

### 12. Litigation

There are no legal or arbitration proceedings (including any such proceedings which are pending or threatened of which BT Group is aware) which may have, or have had, during the 12 months prior to the date of this document, a significant effect on BT Group's financial position.

### 13. Material contracts

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into in the two years preceding the date of this document by BT Group or any other member of the BT Group and are, or may be, material to the BT Group or have been entered into by BT Group or another member of the BT Group and contain any provision under which any member of the BT Group has any obligations or entitlements which are, or may be, material to BT Group or such other member of the BT Group:

#### (a) Demerger Agreements

The following agreements which BT Group entered into for the purpose of giving effect to the Demerger are disclosed in more detail in Part 2 of this document:

- (i) Demerger Agreement;
- (ii) Separation Agreement;
- (iii) Tax Agreement;

- (iv) Framework Agreement; and
- (v) Wireless Trading Agreement.

**(b) Viag Interkom**

On 16 August 2000, BT, through its wholly-owned subsidiary BT Interkom Verwaltungs GmbH, entered into option agreements with each of its partners in the Viag Interkom joint venture, E.ON AG and Telenor A.S. giving BT the option to purchase, and the other partners the right to sell, their interests in the Viag Interkom joint venture which holds a third generation mobile telecommunications licence in Germany.

On 29 December 2000, Telenor group exercised its option pursuant to which BT Interkom Verwaltungs GmbH purchased Telenor AS's 10 per cent. share of the venture on 18 January 2001. On 15 January 2001 E.ON AG exercised its option pursuant to which BT Interkom Verwaltungs GmbH purchased E.ON AG's 45 per cent. share of the venture on 19 February 2001.

The purchase prices for E.ON AG's 45 per cent. share and Telenor AS's 10 per cent. share of the venture were Euro 7.25 billion and Euro 1.61 billion respectively.

The agreement with E.ON includes the right for BT to continue to use the name "VIAG" or "Viag Interkom" for three years, following which they may enter into good faith negotiations for its continued use. It also contains covenants restricting E.ON's rights to compete with Viag Interkom for 12 months.

The agreement with Telenor contains certain indemnities granted by BT to Telenor.

**(c) Japan**

A sale and purchase agreement dated 2 May 2001 between BT, Tadpole BV, a subsidiary of BT, Vodafone Group plc ("Vodafone") and a subsidiary of Vodafone, under which the subsidiary of BT agreed to sell subsidiaries which held its interests in Japan Telecom Co., Ltd. ("JT"), J-Phone Communications Co., Ltd. ("JPC"), J-Phone Central Co., Ltd ("JC"), J-Phone East Co, Ltd. ("JEC") and J-Phone West Co., Ltd. ("JWC"). JT is one of Japan's leading telecommunications companies and parent of JPC, which in turn has controlling interests in the three regional J-Phone wireless operating companies, JC, JEC and JWC. The consideration for the transaction comprised a cash payment of £3.7 billion, and the assumption by Vodafone of £782 million of BT debt guarantees in favour of JT. The sale of the subsidiaries which held BT's interests in JT and JPC (for £3.05 billion) was completed on 1 June 2001. The sale of BT's interests in JEC and JWC for the Euro equivalent of £650 million was completed on 12 July 2001, following exercise of certain options over shares in JC, JEC and JWC, with the exercise price of approximately £380 million having been paid by BT. The agreement contains certain standard warranties and indemnities in favour of Vodafone. These largely expire on 30 June 2002, although certain limited tax and title warranties survive indefinitely.

**(d) Spain**

A sale and purchase agreement dated 2 May 2001, between BT, BT (Netherlands) Holding BV, a subsidiary of BT, and Vodafone under which the BT subsidiary agreed to sell its entire interest in Airtel Móvil, S.A. to Vodafone. The sale was completed on 29 June 2001 for a consideration of £1.1 billion (paid in Euros).

**(e) Yell**

On 25 May 2001 the following agreements were entered into, under which BT agreed to sell its classified advertising directory businesses in the UK and the USA:

- (i) umbrella agreement between Yell Limited, BT Holdings Ltd, Yellow Pages BV, Marchprobe Ltd, Castaim Ltd, Yasmin Two (US) Inc and BT;
- (ii) UK share sale agreement between BT Holdings Ltd and Marchprobe Ltd under which BT Holdings Ltd agreed to sell the share capital of Yellow Pages Sales Ltd to Marchprobe Ltd;
- (iii) UK business sale agreement between Yell Ltd, BT, Castaim Ltd and Yasmin Two (US) Inc under which Yell Ltd agreed to sell Yell Ltd's business and assets to Castaim Ltd and to sell Yell Ltd's US intellectual property rights to Yasmin Two (US) Inc; and
- (iv) US share sale agreement between Yellow Pages BV and Yasmin Two (US) Inc under which Yellow Pages BV agreed to sell the share capital of Yellow Book USA Inc shares to Yasmin Two (US) Inc.

## **Part 9: Additional information**

The umbrella agreement sets out the common terms which apply to the UK share sale agreement, the UK business sale agreement and the US share sale agreement. The umbrella agreement contains covenants restricting any member of BT from carrying on a competing printed classified directories business for 12 months from completion.

The share sale and business agreements contain standard warranties and indemnities in favour of Marchprobe Ltd, Castaim Ltd and Yasmin Two (US) Inc. The warranties expire on 30 June 2002. A disclosure letter was delivered to Marchprobe Ltd, Castaim Limited and Yasmin Two (US) Inc on signing.

As part of the consideration under the UK business sale agreement Castaim Ltd also assumed responsibility for certain liabilities and obligations of the Yell business.

On, or immediately prior to, completion of the sale (“Completion”), the following agreements were entered into:

- (i) first amending agreement to the umbrella agreement between Yell Limited, BT Holdings Ltd, Yellow Pages BV, Marchprobe Ltd, Castaim Ltd, Yasmin Two (US) Inc, BT and Yellow Book USA, Inc;
- (ii) second amending agreement to the umbrella agreement between Yell Limited, BT Holdings Ltd, Yellow Pages BV, Marchprobe Ltd, Castaim Ltd, Yasmin Two (US) Inc and BT; and
- (iii) administration and services agreement between BT and Castaim Limited concerning the provision of certain services and facilities to the printed classified directories business for a period of six months from Completion.

The sale of Yell was completed on 25 June 2001 for a consideration of £2.14 billion, comprised of (i) £2 million as consideration for the issued shares of Yellow Pages Sales Ltd; (ii) £1,288 million in cash plus £100 million in interest bearing vendor loan notes and £100 million in deferred consideration (subject to reduction on ascertainment of the net assets) as consideration for the assets of Yell Ltd; (iii) £1 as consideration for the US intellectual property rights; and (iv) £650 million as consideration for the issued shares of Yellow Book USA Inc. (subject to adjustment in respect of certain intra-group indebtedness and pursuant to the terms of the first amending agreement).

Following Completion, Yell Ltd agreed a net assets adjustment with Castaim Ltd in respect of the assets of Yell Ltd, and Yellow Pages BV agreed a net asset adjustment with Yasmin Two (US) Inc in respect of Yellow Book USA, Inc, which together resulted in the total purchase consideration received being reduced by approximately £140 million.

### **14. Working capital**

The Company is of the opinion that the BT Group has sufficient working capital for its present requirements, that is for at least the next 12 months from the date of the publication of this document.

### **15. Consents**

- (a) Cazenove has given and has not withdrawn its written consent to the inclusion in this document of its name and the references to it in the form and context in which they appear.
- (b) PricewaterhouseCoopers have given and not withdrawn their written consent to the inclusion in this document of their letter and report and the references thereto and to their name in the form and context in which they appear and have authorised the contents of their letter and report for the purposes of section 152(1)(e) of the Financial Services Act 1986.
- (c) The Law Debenture Trust Corporation p.l.c. has given and has not withdrawn its written consent to the inclusion in this document of its name and the references to it in the form and context in which they appear.

### **16. Tax confirmations**

The Inland Revenue has granted clearances (which remain subject to confirmation) in respect of the Scheme and the Demerger under section 215 Income and Corporation Taxes Act 1988 (“ICTA”), under section 707 ICTA and under section 138 and section 139 Taxation of Chargeable Gains Act 1992.

### **17. Miscellaneous**

- (a) The total costs and expenses of, or incidental to, the Proposals are estimated to be approximately £84 million (exclusive of VAT), of which £83 million is payable by BT and £1 million is payable by mmO<sub>2</sub> Group.
- (b) The auditors of BT Group are PricewaterhouseCoopers, Chartered Accountants and Registered Auditors, whose address is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers, or Coopers & Lybrand who merged with Price



Waterhouse on 1 July 1998 to form PricewaterhouseCoopers, have audited the consolidated financial statements of BT for the three years ended 31 March 2001.

- (c) PricewaterhouseCoopers have audited the non-statutory accounts of the Company for the period from incorporation, 30 March 2001, to 30 June 2001. No other accounts of the Company have been prepared or audited.
- (d) Directors and employees of Cazenove, the sponsor and financial adviser to the Company, who have been advising the Company hold, in aggregate, an interest in 442 BT Group Shares.
- (e) The BT Group Shares are not being marketed to, nor are any available for purchase in whole or in part by, the public in the United Kingdom or elsewhere in connection with the Admission to the Official List. No application is being made for the BT Group Shares to be listed in Japan.
- (f) The financial information set out in this document does not constitute statutory accounts within the meaning of section 240(5) of the Act. Statutory accounts for BT for each of the three years ended 31 March 1999, 2000 and 2001 have been delivered to the Registrar of Companies in England and Wales. The auditors of BT have made reports under section 235 of the Act in respect of these statutory accounts and each such report was an unqualified report and did not contain a statement under section 237(2) or (3) of the Act.

#### **18. Documents available for inspection**

Copies of the following documents will be available for inspection during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the registered office of the Company and at the offices of Linklaters, One Silk Street, London EC2Y 8HQ during normal business hours from the date this document is published to the date of the meetings, 23 October 2001:

- (a) the memorandum and articles of association of the Company;
- (b) the audited consolidated financial statements of BT for the three years ended 31 March 1999, 2000 and 2001;
- (c) the letter and report by PricewaterhouseCoopers set out in Part 5 of this document and the statements attached to them;
- (d) the letters of consent referred to in paragraph 15 above;
- (e) the rules of the BT Share Schemes;
- (f) the rules of the proposed new employee share schemes for BT Group together with the related trust deeds;
- (g) the Circular and flyer;
- (h) the service agreements referred to in paragraph 6 of this Part 9; and
- (i) the material contracts referred to in paragraph 13 of this Part 9.

Dated 18 September 2001



**BT Group plc**

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