

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1 Basis of preparation and accounting policies

These condensed consolidated financial statements (“the financial statements”) comprise the financial results of BT Group plc for the quarters and half years to 30 September 2009 and 2008 together with the audited balance sheet at 31 March 2009. The financial statements for the quarter and half year to 30 September 2009 have been reviewed by the auditors and their review opinion is on page 24. The financial statements have been prepared in accordance with the Disclosure and Transparency Rules (DTR) of the Financial Services Authority and with IAS 34 *Interim Financial Reporting* as adopted by the European Union. The financial statements should be read in conjunction with the annual financial statements for the year to 31 March 2009.

Except as described below, the financial statements have been prepared in accordance with the accounting policies as set out in the financial statements for the year to 31 March 2009 and have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value. These financial statements do not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006. Statutory accounts for the year to 31 March 2009 were approved by the Board of Directors on 13 May 2009, published on 27 May 2009 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified and did not contain any statement under Section 237 of the Companies Act 1985.

The following new standards, amendments to new standards and interpretations which are relevant for the group have been adopted with effect from 1 April 2009:

- IAS 1 (revised), *Presentation of Financial Statements*;
- IAS 23 (Amended), *Borrowing Costs*;
- IFRS 2, *Share-Based Payment – Vesting Conditions and Cancellations*;
- IFRS 8, *Operating Segments*;
- IFRIC 12, *Service Concession Arrangements*;
- IFRIC 13, *Customer Loyalty Programmes*; and
- IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*.

The adoption of the amendment to IFRS 2 *Share-Based Payment – Vesting Conditions and Cancellations* has resulted in a change in the group’s accounting policy for share based payments. The amendment clarifies that only service and performance conditions are vesting conditions. Any other conditions are non-vesting conditions which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as a result of a failure to meet a non-vesting condition that is within the control of either the group or the counterparty, this must be treated as a cancellation. Cancellations are treated as accelerated vestings and all remaining future charges are immediately recognised in the income statement with the credit recognised directly in equity. Hence the overall impact on net assets and cash flow is nil. Prior to the adoption of the amendment to IFRS 2 the monthly savings requirement under the group’s all employee sharesave plans was classified as a vesting condition and any cancellations made by employees prior to the normal vesting date resulted in the reversal of all charges recognised to date.

Restatements – impact of new accounting standards

The amendment to IFRS 2 requires retrospective adoption and hence comparative periods have been restated. This has resulted in a reduction in EBITDA of £22m for Q2 2008/09 and £38m for HY 2008/09. The restatements have been included in the ‘Other’ segment. The adoption of IAS 1 (revised), *Presentation of Financial Statements* has resulted in a change in accounting policy applied to the classification of derivatives which have not been allocated to a specific hedge relationship. Where such derivatives, previously reported as current assets and current liabilities, have a maturity of and are expected to be held for more than twelve months after the reporting period, they will now be presented as non current assets or liabilities. Prior period balance sheets have been reclassified to be on a consistent basis. The effect of all these restatements was disclosed in Note 14 to the financial statements for the first quarter to 30 June 2009.

None of the other new standards, amendments or interpretations referred to above has a significant impact on the group’s results.

Restatements – internal charges

We have also restated the line of business 2008/09 income statement comparatives for the impact of customer account moves between BT Global Services and BT Retail and other internal trading model changes effective from 1 April 2009. These restatements have no impact on total group results. The effect of these restatements was disclosed in Note 14 to the financial statements for the first quarter to 30 June 2009.

2 Operating results – by line of business

	External revenue ¹ £m	Internal revenue £m	Group revenue £m	EBITDA ¹ £m	Group operating profit (loss) ¹ £m
Second quarter to 30 September 2009					
BT Global Services	2,024	-	2,024	95	(96)
BT Retail	1,972	90	2,062	475	356
BT Wholesale	817	308	1,125	328	158
Openreach	299	986	1,285	507	284
Other	10	-	10	31	(25)
Intra-group items ²	-	(1,384)	(1,384)	-	-
Total	5,122	-	5,122	1,436	677
Second quarter to 30 September 2008³					
BT Global Services	2,095	-	2,095	105	(66)
BT Retail	2,094	82	2,176	429	327
BT Wholesale	860	308	1,168	324	152
Openreach	242	1,061	1,303	489	300
Other	12	-	12	60	9
Intra-group items ²	-	(1,451)	(1,451)	-	-
Total	5,303	-	5,303	1,407	722
Half year to 30 September 2009					
BT Global Services	4,103	-	4,103	157	(220)
BT Retail	3,999	173	4,172	951	715
BT Wholesale	1,653	614	2,267	648	307
Openreach	579	2,012	2,591	1,010	586
Other	23	-	23	41	(78)
Intra-group items ²	-	(2,799)	(2,799)	-	-
Total	10,357	-	10,357	2,807	1,310
Half year to 30 September 2008³					
BT Global Services	4,089	-	4,089	287	(65)
BT Retail	4,184	150	4,334	806	604
BT Wholesale	1,709	615	2,324	648	306
Openreach	479	2,130	2,609	980	607
Other	19	-	19	103	(4)
Intra-group items ²	-	(2,895)	(2,895)	-	-
Total	10,480	-	10,480	2,824	1,448

¹ Before specific items and leaver costs.

² Elimination of intra-group revenue, which is included in the total revenue of the originating business.

³ Restated – see Note 1 for details.

3 Capital expenditure – by line of business

	Second quarter to 30 September		Half year to 30 September	
	2009	2008	2009	2008
	£m	£m	£m	£m
BT Global Services	131	213	262	458
BT Retail	82	117	163	244
BT Wholesale	69	119	140	239
Openreach	200	230	403	457
Other	76	87	149	170
Total	558	766	1,117	1,568

4 Operating costs

	Second quarter to 30 September		Half year to 30 September	
	2009	2008 ¹	2009	2008 ¹
	£m	£m	£m	£m
Staff costs before leaver costs	1,206	1,344	2,472	2,730
Leaver costs	21	36	66	109
Staff costs	1,227	1,380	2,538	2,839
Own work capitalised	(133)	(155)	(277)	(313)
Net staff costs	1,094	1,225	2,261	2,526
Depreciation and amortisation	759	685	1,497	1,376
Payments to telecommunication operators	1,040	1,043	2,088	2,080
Other operating costs	1,666	1,771	3,439	3,356
Total before specific items	4,559	4,724	9,285	9,338
Specific items (Note 5)	54	38	95	65
Total	4,613	4,762	9,380	9,403

¹ Restated – see Note 1 for details.

5 Specific items

BT separately identifies and discloses any significant one-off or unusual items (termed “specific items”). This is consistent with the way that financial performance is measured by management and we believe assists in providing a meaningful analysis of the trading results of the group. Specific items may not be comparable to similarly titled measures used by other companies.

	Second quarter to 30 September		Half year to 30 September	
	2009	2008	2009	2008
	£m	£m	£m	£m
Revenue provision for regulatory settlement	52	-	52	-
BT Global Services restructuring charges	49	-	90	-
Group transformation and reorganisation costs	-	38	-	65
Costs associated with settlement of prior tax years	5	-	5	-
Specific operating costs	54	38	95	65
Net specific items before interest	106	38	147	65
Interest income on settlement of prior tax years	(11)	-	(11)	-
Net specific items charge before tax	95	38	136	65
Tax credit on specific items	(21)	(10)	(32)	(18)
Tax credit in respect of settlement of prior tax years	(215)	-	(215)	-
Net specific items (credit) charge after tax	(141)	28	(111)	47

6 Net finance expense

	Second quarter to 30 September		Half year to 30 September	
	2009 £m	2008 £m	2009 £m	2008 £m
Net finance expense before pensions ^{1,2}	214	237	428	445
Net interest expense (income) on pensions	70	(78)	139	(156)
Net finance expense	284	159	567	289

¹ Finance expense in the second quarter and half year to 30 September 2009 includes a £6m and £5m net charge (Q2 08/09: £11m, HY 08/09: £8m net charge), respectively, arising from the re-measurement of financial instruments on a fair value basis which under IAS 39, are not in hedging relationships.

² Includes £11m of interest income on settlement of prior tax years in the second quarter and half year to 30 September 2009 which has been disclosed as a specific item (Note 5).

7 Dividends

	Half year to 30 September		Half year to 30 September	
	2009 Pence per share	2008	2009 £m	2008 £m
Amounts recognised as distributions to equity holders in the period	1.1	10.4	85	804

The Board has declared an interim dividend of 2.3p per share (Q2 2008/09: 5.4p), payable on 8 February 2010 to the shareholders on the register at the close of business on 29 December 2009. This interim dividend, amounting to £178m (Q2 2008/09: £418m), has not been included as a liability as at 30 September 2009. The final dividend for the year to 31 March 2009 of 1.1p per share was approved at the Annual General Meeting on 15 July 2009 and was paid in the second quarter.

8 Earnings before interest, taxation, depreciation and amortisation (EBITDA)

Earnings before interest, taxation, depreciation and amortisation (EBITDA) before specific items and leaver costs is not a measure recognised under IFRS, but it is a key indicator used by management in order to assess operational performance. A reconciliation of reported profit before tax to adjusted EBITDA is provided below.

	Second quarter to 30 September		Half year to 30 September	
	2009 £m	2008 £m	2009 £m	2008 £m
Reported profit before tax	275	494	547	991
Share of post tax profits of associates and joint ventures	(9)	(5)	(17)	(6)
Net finance expense (Note 6)	284	159	567	289
Operating profit	550	648	1,097	1,274
Depreciation and amortisation (Note 4)	759	685	1,497	1,376
Reported EBITDA	1,309	1,333	2,594	2,650
Leaver costs (Note 4)	21	36	66	109
Specific items (Note 5)	106	38	147	65
Adjusted EBITDA	1,436	1,407	2,807	2,824

9 Reconciliation of adjusted profit before tax

	Second quarter to 30 September		Half year to 30 September	
	2009	2008 ¹	2009	2008 ¹
	£m	£m	£m	£m
Reported profit before tax	275	494	547	991
Leaver costs (Note 4)	21	36	66	109
Specific items (Note 5)	95	38	136	65
Net interest expense (income) on pensions (Note 6)	70	(78)	139	(156)
Adjusted profit before tax	461	490	888	1,009

¹ Restated – see Note 1 for details.

10 Reconciliation of adjusted earnings per share

	Second quarter to 30 September		Half year to 30 September	
	2009	2008 ¹	2009	2008 ¹
	pence per share		pence per share	
Reported basic earnings per share	5.5	4.9	8.3	9.8
Per share impact of:				
- Leaver costs	0.2	0.4	0.6	1.0
- Specific items	(1.8)	0.4	(1.4)	0.6
- Net interest expense (income) on pensions	0.6	(0.8)	1.3	(1.4)
Adjusted earnings per share	4.5	4.9	8.8	10.0

¹ Restated – see Note 1 for details.

11 Free cash flow

Free cash flow is defined as the net increase in cash and cash equivalents less cash flows from financing activities (except interest paid), less the acquisition or disposal of group undertakings and less the net sale of short term investments. It is not a measure recognised under IFRS but is a key indicator used by management in order to assess operational performance.

	Second quarter to 30 September		Half year to 30 September	
	2009	2008	2009	2008
	£m	£m	£m	£m
Cash generated from operations	1,211	1,225	1,840	1,612
Tax received (paid)	201	(2)	411	(2)
Net cash inflow from operating activities	1,412	1,223	2,251	1,610
Included in cash flows from investing activities				
Net purchase of property, plant, equipment and software	(555)	(712)	(1,233)	(1,548)
Dividends received from associates	-	3	1	3
Interest received	12	5	13	12
Included in cash flows from financing activities				
Interest paid	(164)	(150)	(449)	(442)
Free cash flow	705	369	583	(365)

12 Net debt

Net debt at 30 September 2009 was £9,878m (31 March 2009: £10,361m; 30 September 2008: £11,028m). Net debt consists of loans and other borrowings less current asset investments and cash and cash equivalents. Loans and other borrowings are measured at the net proceeds raised, adjusted to amortise any discount over the term of the debt. For the purpose of this analysis, current asset investments and cash and cash equivalents are measured at the lower of cost and net realisable value. Currency denominated balances within net debt are translated to Sterling at swapped rates where hedged.

This definition of net debt measures balances at the expected value of future undiscounted cash flows due to arise on maturity of financial instruments and removes the balance sheet adjustments made from the re-measurement of hedged risks under fair value hedges and the use of the effective interest method as required by IAS 39. Net debt is a non GAAP measure since it is not defined in IFRS but it is a key indicator used by management in order to assess operational performance.

During the half year to 30 September 2009, the group issued debt of £522m consisting mainly of a £520m long term listed bond maturing in 2014. Debt maturities amounted to £981m consisting of long term debt of £290m and net commercial paper maturities of £691m.

During the half year to 30 September 2008, the group issued debt of £1,574m consisting of a long term listed bond of £794m maturing in 2015 and net commercial paper issuances of £780m. Debt maturities amounted to £627m.

(a) Analysis of net debt

	At 30 September	
	2009	2008
	£m	£m
Loans and other borrowings ¹	12,693	12,635
Cash and cash equivalents	(385)	(915)
Investments	(921)	(214)
	11,387	11,506
Adjustments:		
To re-translate currency denominated balances at swapped rates where hedged	(1,169)	(155)
To recognise borrowings at net proceeds adjusted to amortise discount and investments at the lower of cost and net realisable value	(340)	(323)
Net debt	9,878	11,028

¹ Includes overdrafts of £17m at 30 September 2009 (30 September 2008: £112m)

After allocating the element of the above adjustments which impacts loans and other borrowings, gross debt at 30 September 2009 was £11,184m (31 March 2009: £11,663m; 30 September 2008: £12,066m). The adjustment to re-translate currency denominated balances at swapped rates where hedged reflects the foreign exchange impact of currency swaps which offset the foreign exchange movement on revaluing currency loans and borrowings.

(b) Reconciliation of movement in net debt

	Second quarter to 30 September		Half year to 30 September	
	2009	2008	2009	2008
	£m	£m	£m	£m
Net debt at beginning of period	10,517	10,581	10,361	9,460
(Reduction) increase in net debt	(620)	450	(485)	1,549
Net debt assumed on acquisitions	-	-	-	18
Currency movements	(13)	(9)	12	(8)
Other non-cash movements	(6)	6	(10)	9
Net debt at end of period	9,878	11,028	9,878	11,028

13 Share capital

During the half year to 30 September 2009, the company purchased nil (HY 2008/09: 142m) of its own shares of 5p each for consideration of £nil (HY 2008/09: £309m). 2m (HY 2008/09: 88m) shares were issued from treasury to satisfy obligations under employee share schemes and executive awards at a cost of £7m (HY 2008/09: £123m). Nil (HY 2008/09: 250m) treasury shares were cancelled at a cost of £nil (HY 2008/09: £797m).

14 Capital commitments

Capital expenditure for property, plant equipment and software contracted for at the balance sheet date but not yet incurred was £386m (31 March 2009: £451m; 30 September 2008: £750m).

15 Related party transactions

During the half year to 30 September 2009, the group purchased services in the normal course of business and on an arm's length basis from its associate, Tech Mahindra Limited. The value of services purchased was £156m (30 September 2008: £153m) and the amounts outstanding and payable for services at 30 September 2009 was £66m (30 September 2008: £58m).

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors confirm, to the best of their knowledge, that this condensed set of financial statements has been prepared in accordance with IAS 34 as adopted by the European Union and that the Interim Management Report includes a fair review of the information required by Rules 4.2.7 and 4.2.8 of the Disclosure and Transparency Rules of the United Kingdom Financial Services Authority.

The names and functions of the BT Group plc board can be found at:
<http://www.btplc.com/Thegroup/Ourcompany/Theboard/index.htm>

11 November 2009