

## 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 nine months to 31 December 2008 and 2007, together with the audited balance sheet at 31 March 2008. The financial statements for the quarter and nine months to 31 December 2008 have been reviewed by the auditors and their review opinion is on page 25. The financial statements should be read in conjunction with the annual financial statements for the year to 31 March 2008. The financial statements have also been prepared in accordance with the accounting policies as set out in the 2008 Annual Report 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. The 2008 Annual Report refers to new accounting standards and interpretations effective from 1 April 2008. None of these standards or interpretations have had a material impact on these financial statements.

The financial statements do not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985. Statutory accounts for the year to 31 March 2008 were approved by the Board of Directors on 14 May 2008, published on 28 May 2008 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.

In the fourth quarter and full year to 31 March 2008 certain investments previously held within cash and cash equivalents were reclassified to current available-for-sale assets, as management considered this to be the more appropriate maturity classification. Balance sheet comparative amounts at 31 December 2007 have been reclassified by £724m to provide a consistent presentation. The impact in the cash flow statement for the quarter to 31 December 2007 has been to increase 'Sale of current financial assets' and 'Purchases of current financial assets' by £985m and £1,099m, respectively, and to decrease opening and closing cash and cash equivalents by £608m and £724m, respectively.

We draw your attention to the discussion of the ongoing operational and contract reviews on page 4. The contract reviews, together with ongoing commercial discussions in respect of two of our largest contracts are likely to be completed during the fourth quarter. These may result in further substantial one-off charges in the current financial year, the need for and size of which will be highly dependent on the outcome of the ongoing discussions.

## 2 Results of businesses

### (a) Operating results

	External revenue £m	Internal revenue £m	Group revenue £m	EBITDA (i) £m	Group operating profit (loss) £m
<b>Third quarter to 31 December 2008</b>					
BT Global Services	2,253	-	2,253	(319)	(501)
BT Retail	2,040	94	2,134	428	316
BT Wholesale	876	307	1,183	319	141
Openreach	257	1,072	1,329	533	344
Other	11	-	11	39	(23)
Intra-group items (ii)	-	(1,473)	(1,473)	-	-
<b>Total</b>	<b>5,437</b>	<b>-</b>	<b>5,437</b>	<b>1,000</b>	<b>277</b>
<b>Third quarter to 31 December 2007</b>					
BT Global Services	1,965	-	1,965	215	22
BT Retail	2,074	72	2,146	402	291
BT Wholesale	890	315	1,205	344	120
Openreach	218	1,100	1,318	489	323
Other	7	-	7	19	(19)
Intra-group items (ii)	-	(1,487)	(1,487)	-	-
<b>Total</b>	<b>5,154</b>	<b>-</b>	<b>5,154</b>	<b>1,469</b>	<b>737</b>
<b>Nine months to 31 December 2008</b>					
BT Global Services	6,462	-	6,462	(5)	(540)
BT Retail	6,113	257	6,370	1,217	903
BT Wholesale	2,585	922	3,507	961	441
Openreach	728	3,210	3,938	1,513	951
Other	29	-	29	176	8
Intra-group items (ii)	-	(4,389)	(4,389)	-	-
<b>Total</b>	<b>15,917</b>	<b>-</b>	<b>15,917</b>	<b>3,862</b>	<b>1,763</b>
<b>Nine months to 31 December 2007</b>					
BT Global Services	5,663	-	5,663	579	36
BT Retail	6,116	203	6,319	1,120	794
BT Wholesale	2,847	932	3,779	1,081	438
Openreach	637	3,309	3,946	1,442	925
Other	19	-	19	120	15
Intra-group items (ii)	-	(4,444)	(4,444)	-	-
<b>Total</b>	<b>15,282</b>	<b>-</b>	<b>15,282</b>	<b>4,342</b>	<b>2,208</b>

(i) Before specific items and leaver costs.

(ii) Elimination of intra-group revenue between businesses, which is included in the total revenue of the originating business.

In 2008/09 we have allocated any over or under recovery of direct costs in BT Design and BT Operate to the four customer facing lines of business. This amounts to £34m of operating costs and £105m of depreciation in the nine months to 31 December 2008. In 2007/08 there was no such allocation as we were transforming the business and developing the trading model.

In 2008/09 we have allocated foreign exchange losses of £40m arising from the retranslation of intra group balances to the group's corporate treasury operations in the Other category. In 2007/08 there was no such allocation as the amounts involved were immaterial.

## 2 Results of businesses (continued)

### (b) Product revenue analysis

	Third quarter to 31 December				Nine months to 31 December	
	2008	2007	Change		2008	2007
	£m	£m	£m	%	£m	£m
Managed solutions	1,662	1,346	316	23	4,593	3,750
Broadband and convergence	679	639	40	6	1,968	1,890
Calls and lines	1,558	1,695	(137)	(8)	4,806	5,184
Transit, conveyance, interconnect circuits, WLR, global carrier and other wholesale products	840	835	5	0.6	2,489	2,587
Other	698	639	59	9	2,061	1,871
	<b>5,437</b>	<b>5,154</b>	<b>283</b>	<b>5</b>	<b>15,917</b>	<b>15,282</b>

### (c) Revenue analysis by customer segment

	Third quarter to 31 December				Nine months to 31 December	
	2008	2007	Change		2008	2007
	£m	£m	£m	%	£m	£m
Major corporate	2,166	1,882	284	15	6,182	5,422
Business	659	647	12	2	1,980	1,914
Consumer	1,218	1,292	(74)	(6)	3,682	3,812
Wholesale/carrier	1,383	1,326	57	4	4,044	4,115
Other	11	7	4	57	29	19
	<b>5,437</b>	<b>5,154</b>	<b>283</b>	<b>5</b>	<b>15,917</b>	<b>15,282</b>

### (d) Capital expenditure on property, plant, equipment, software and motor vehicles

	Third quarter to 31 December				Nine months to 31 December	
	2008	2007	Change		2008	2007
	£m	£m	£m	%	£m	£m
Transmission equipment	323	267	56	21	776	835
Exchange equipment	16	13	3	23	35	68
Other network equipment	149	304	(155)	(51)	691	870
Computers and office equipment	46	71	(25)	(35)	108	126
Software	201	196	5	3	652	606
Motor vehicles and other	27	5	22	n/m	57	30
Land and buildings	-	7	(7)	n/m	11	30
	<b>762</b>	<b>863</b>	<b>(101)</b>	<b>(12)</b>	<b>2,330</b>	<b>2,565</b>

### 3 (a) Operating costs

	Third quarter to		Nine months to	
	31 December		31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
Staff costs before leaver costs	1,317	1,273	4,001	3,869
Leaver costs	33	20	142	71
Staff costs	1,350	1,293	4,143	3,940
Own work capitalised	(192)	(177)	(505)	(556)
Net staff costs	1,158	1,116	3,638	3,384
Depreciation and amortisation	723	732	2,099	2,134
Payments to telecommunication operators	1,094	1,023	3,174	3,139
Other operating costs	2,289	1,649	5,653	4,711
<b>Total before specific items</b>	<b>5,264</b>	<b>4,520</b>	<b>14,564</b>	<b>13,368</b>
Specific items (note 4)	-	126	65	366
<b>Total</b>	<b>5,264</b>	<b>4,646</b>	<b>14,629</b>	<b>13,734</b>

### (b) Leaver costs

	Third quarter to		Nine months to	
	31 December		31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
BT Global Services	12	1	38	11
BT Retail	2	2	9	7
BT Wholesale	1	-	3	1
Openreach	-	3	10	11
Other	18	14	82	41
<b>Total</b>	<b>33</b>	<b>20</b>	<b>142</b>	<b>71</b>

#### 4 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.

	Third quarter to 31 December		Nine months to 31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
Restructuring costs	-	76	65	292
Write off of circuit inventory and other working capital balances	-	50	-	74
Specific operating costs	-	126	65	366
Loss on sale of non current asset investments	-	9	-	10
Reassessment of carrying value of associate	(36)	-	(36)	-
Profit on disposal of associate	-	(1)	-	(10)
Net specific items (credit) charge before tax	(36)	134	29	366
Tax credit on specific items	-	(38)	(18)	(110)
Tax credit on re-measurement of deferred tax	-	-	-	(154)
<b>Net specific items (credit) charge after tax</b>	<b>(36)</b>	<b>96</b>	<b>11</b>	<b>102</b>

#### 5 Net finance expense

	Third quarter to 31 December		Nine months to 31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
Finance expense <sup>1</sup> before pension interest	266	261	729	646
Interest on pension scheme liabilities	577	507	1,731	1,521
Finance expense	843	768	2,460	2,167
Finance income before pension income	(7)	(22)	(25)	(50)
Expected return on pension scheme assets	(656)	(612)	(1,966)	(1,836)
Finance income	(663)	(634)	(1,991)	(1,886)
Net finance expense	180	134	469	281
Net finance expense before pensions	259	239	704	596
Interest associated with pensions	(79)	(105)	(235)	(315)
<b>Net finance expense</b>	<b>180</b>	<b>134</b>	<b>469</b>	<b>281</b>

<sup>1</sup> Finance expense in the third quarter and nine months to 31 December 2008 includes a £21m and £29m net charge, respectively, arising from the re-measurement of financial instruments which under IAS 39 are not in hedging relationships on a fair value basis. Finance expense in the third quarter and nine months to 31 December 2007 includes a £36m and £39m net charge, respectively, arising from the re-measurement of financial instruments which under IAS 39 are not in hedging relationships on a fair value basis. This includes a charge in the third quarter of £26m on a low cost borrowing transaction which was marginally earnings positive after tax in the period.

## 6 Earnings per share

The basic earnings per share are calculated by dividing the profit attributable to shareholders by the average number of shares in issue after deducting the company's shares held by employee share ownership trusts and treasury shares. In calculating the diluted earnings per share, share options outstanding and other potential ordinary shares have been taken into account. The average number of shares in the periods were:

	Third quarter to		Nine months to	
	31 December		31 December	
	2008	2007	2008	2007
	millions of shares		millions of shares	
Basic	7,733	8,037	7,721	8,120
Diluted	7,772	8,241	7,769	8,332

## 7 (a) Reconciliation of profit before tax to cash generated from operations

	Third quarter to		Nine months to	
	31 December		31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
Profit before tax	116	447	1,145	1,482
Depreciation and amortisation	723	732	2,099	2,134
Net finance expense	180	134	469	281
Associates and joint ventures	(52)	2	(58)	8
Share based payment	-	19	33	55
Loss on disposal of associates and non current asset investments	-	8	-	-
Decrease (increase) in working capital	130	(294)	(1,000)	(1,219)
Provisions, pensions and other movements	74	22	95	(177)
<b>Cash generated from operations</b>	<b>1,171</b>	<b>1,070</b>	<b>2,783</b>	<b>2,564</b>

## (b) Free cash flow

	Third quarter to		Nine months to	
	31 December		31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
<b>Cash generated from operations</b>	<b>1,171</b>	<b>1,070</b>	<b>2,783</b>	<b>2,564</b>
Income taxes (paid) received	(111)	(70)	(113)	314
<b>Net cash inflows from investing activities</b>	<b>1,060</b>	<b>1,000</b>	<b>2,670</b>	<b>2,878</b>
<b>Included in cash flows from investing activities</b>				
Net purchase of property, plant, equipment and software	(789)	(877)	(2,337)	(2,494)
Net purchase of non current asset investments	-	(1)	-	(1)
Dividends received from associates	2	1	5	2
Interest received	6	15	18	101
<b>Included in cash flows from financing activities</b>				
Interest paid	(311)	(359)	(753)	(688)
<b>Free cash flow</b>	<b>(32)</b>	<b>(221)</b>	<b>(397)</b>	<b>(202)</b>

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.

### (c) Cash and cash equivalents

	At 31 December		At 31 March
	2008	2007	2008
	£m	£m	£m
Cash at bank and in hand	746	783	732
Short term deposits	46	165	703
Cash and cash equivalents	792	948	1,435
Bank overdrafts	(192)	(418)	(261)
<b>Total</b>	<b>600</b>	<b>530</b>	<b>1,174</b>

## 8 Net debt

Net debt at 31 December 2008 was £11,060m (31 December 2007: £10,175m; 31 March 2008: £9,460m).

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. In addition, the gross balances are adjusted to take account of netting arrangements amounting to £160m. 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.

### (a) Analysis of net debt

	At 31 December		At 31 March
	2008	2007	2008
	£m	£m	£m
Loans and other borrowings	15,074	11,611	11,342
Cash and cash equivalents	(792)	(948)	(1,435)
Investments	(837)	(724)	(440)
	<b>13,445</b>	<b>9,939</b>	<b>9,467</b>
Adjustments:			
To re-translate currency denominated balances at swapped rates where hedged	(2,070)	404	241
To recognise borrowing and investments at net proceeds and unamortised discount	(315)	(168)	(248)
<b>Net debt</b>	<b>11,060</b>	<b>10,175</b>	<b>9,460</b>

After allocating the element of the adjustments which impact loans and other borrowings, gross debt at 31 December 2008 was £12,527m (31 December 2007: £11,427m; 31 March 2008: £11,076m). The adjustment to retranslate 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. At 31 December 2008, the balance sheet net derivative financial instruments movement primarily reflects this currency impact.

**(b) Reconciliation of movement in net debt**

	Third quarter to 31 December		Nine months to 31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
Net debt at beginning of period	11,028	9,618	9,460	7,914
Increase in net debt resulting from cash flows	80	559	1,629	2,215
Net debt assumed or issued on acquisitions	(20)	-	(2)	31
Currency movements	(38)	(1)	(46)	-
Other non-cash movements	10	(1)	19	15
<b>Net debt at end of period</b>	<b>11,060</b>	<b>10,175</b>	<b>11,060</b>	<b>10,175</b>

**9 Statement of changes in equity**

	Nine months to 31 December		Year to 31 March
	2008	2007	2008
	£m	£m	£m
Shareholders' funds	5,409	4,238	4,238
Minority interest	23	34	34
<b>Equity at beginning of period</b>	<b>5,432</b>	<b>4,272</b>	<b>4,272</b>
Total recognised (expense) income for the period	(1,816)	1,798	3,903
Share based payment	32	38	55
Issues of shares	-	10	32
Tax on items taken directly to equity	-	-	(45)
Net purchase of treasury shares	(63)	(922)	(1,529)
Dividends on ordinary shares	(804)	(810)	(1,241)
Minority interest	(1)	(10)	(15)
Net changes in equity for the period	(2,652)	104	1,160
<b>Equity at end of period</b>			
Shareholders' funds	2,745	4,347	5,409
Minority interest	35	29	23
<b>Total equity</b>	<b>2,780</b>	<b>4,376</b>	<b>5,432</b>

**10 Earnings before interest, taxation, depreciation and amortisation (EBITDA)**

	Third quarter to 31 December		Nine months to 31 December	
	2008	2007	2008	2007
	£m	£m	£m	£m
Operating profit	244	582	1,556	1,761
Depreciation and amortisation (note 3)	723	732	2,099	2,134
Leaver costs (note 3)	33	20	142	71
Specific items (note 4)	-	135	65	376
<b>EBITDA before specific items and leaver costs</b>	<b>1,000</b>	<b>1,469</b>	<b>3,862</b>	<b>4,342</b>
<b>BT Global Services one-off charges</b>	<b>336</b>	<b>-</b>	<b>336</b>	<b>-</b>
<b>EBITDA before one-off charges, specific items and leaver costs</b>	<b>1,336</b>	<b>1,469</b>	<b>4,198</b>	<b>4,342</b>

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.