

## Financial review

Please see cautionary statement regarding forward-looking statements on page 143.

### Introduction

BT's loss of 27.7 pence per share for the year ended 31 March 2001 (the 2001 financial year) compares with earnings of 31.7 pence for the 2000 financial year and 46.3 pence for the 1999 financial year. Exceptional items and goodwill amortisation have affected earnings in each of these years. Earnings for the 2001 financial year were affected by net exceptional charges of 39.6 pence per share, primarily relating to goodwill impairment and mobile subscriber acquisition costs written off partially offset by the profit on disposals of investments and rates refunds. Of the earnings in the 2000 financial year, 0.1 pence per share represented net exceptional income. In the 1999 financial year, net exceptional income amounted to 11.6 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 8.6 pence per share in the 2001 financial year before exceptional charges, by 2.6 pence per share in the 2000 financial year and by 0.3 pence per share in the 1999 financial year. Before goodwill amortisation and exceptional items, earnings of 20.5 pence per share for the 2001 financial year compare with an equivalent 34.2 pence and 35.0 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 BT's recent investment in new businesses and new third-generation mobile licences, as well as losses incurred by our newly acquired businesses and the adverse effect which competitive pressures have had on our

operating margins in the UK fixed-voice telephony and wireless markets. 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, particularly for wireless communications, 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 and wireless phone 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. Our ventures in North America, continental Europe and Asia Pacific which we have established, or in which we have acquired interests, in recent years, contributed significantly to our total turnover growth. However, the initial losses incurred by many in their development stages are, as anticipated, adversely affecting the group's results. We continue to be affected by the tight regulatory regime in the UK. Price reductions, including those imposed by the price control formulae, totalled approximately £200 million in the 2001 financial year, following reductions of approximately £550 million in the 2000 financial year and over £500 million in the 1999 financial year.

The 2001 financial year has been dominated by the restructuring of our previously centrally organised business into several decentralised lines of business, by our acquisitions of interests and mobile licences in Europe and by the consequent increase in net debt, which rose to £27.9 billion at

Summarised profit and loss account	2001 £m	2000 £m	1999 £m
<b>Total turnover</b>	<b>29,666</b>	21,903	18,223
Group's share of ventures' turnover	(9,937)	(3,364)	(1,270)
Trading between group and principal joint venture	698	176	-
<b>Group turnover</b>	<b>20,427</b>	18,715	16,953
Other operating income	393	242	168
Operating costs	(20,759)	(15,359)	(13,305)
Group operating profit (loss)	61	3,598	3,816
Group's share of ventures' losses	(397)	(400)	(342)
Total operating profit (loss)	(336)	3,198	3,474
Profit on sale of fixed asset investments and group undertakings	619	126	1,107
Net interest	(1,314)	(382)	(286)
<b>Profit (loss) before taxation</b>	<b>(1,031)</b>	2,942	4,295
Taxation	(652)	(897)	(1,293)
<b>Profit (loss) after taxation</b>	<b>(1,683)</b>	2,045	3,002
Minority interests	(127)	10	(19)
<b>Profit (loss) for the financial year</b>	<b>(1,810)</b>	2,055	2,983
<b>Basic earnings (loss) per share</b>	<b>(27.7)p</b>	31.7p	46.3p
<b>Profit before goodwill amortisation, exceptional items and taxation</b>	<b>2,072</b>	3,100	3,274
<b>Basic earnings per share before goodwill amortisation and exceptional items</b>	<b>20.5p</b>	34.2p	35.0p

31 March 2001. Towards the end of the 2001 financial year, in January and February 2001, we acquired the 55% interest in Viag Interkom of Germany we did not already own. Earlier on in the year, in June 2000, we acquired the 50% interest in Telfort of The Netherlands not already owned.

During the year, we 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. We also acquired a significant economic interest in the J-Phone mobile businesses in Japan in May 2000 which we have now agreed to sell to Vodafone, our main competitor in the wireless market in the UK and elsewhere in Europe. In order to finance these investments, we issued two significant series of bonds totalling £13 billion, one primarily in the US and the other primarily in Europe. In November 2000, we sold our 34% interest in sunrise communications at a profit of £454 million.

In early January 2000, Concert, our global venture 50/50 owned with AT&T, was established. Concert took over a major part of our international communications activities and is currently managing the communication needs of a number of our multinational corporate customers. At the same time, it also acquired the Concert Communications Services group (Concert Communications) from BT. As a consequence, from the last quarter of the 2000 financial year, certain of the group's former turnover is reported as part of our proportionate share of our joint ventures' turnover. Also in the 2000 financial year, BT took a 30% interest, jointly with AT&T, in Japan Telecom, acquired the remaining 40% 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 has been acquired by Vodafone in April 2001 and in May 2001 we agreed to sell our interest in Japan Telecom also to that company.

In the 1999 financial year, the group's interest in MCI, held since 1994, was sold on the completion of the MCI/WorldCom merger. We recognised a pre-tax profit of £1,133 million on this sale; this followed the £273 million fee we received in November 1997 on the announcement of their agreed merger, as compensation for the break-off of the merger we had planned with MCI. We ceased equity accounting for MCI as an associate on 31 October 1997. At the same time as we disposed of our interest in MCI in September 1998, we acquired the minority interest owned by MCI in Concert Communications.

On 10 May 2001, we announced our intention to demerge BT Wireless later in 2001 to create two separately listed companies; the first, BT Wireless, will comprise our controlled wireless operations in Europe, and the other, Future BT, will be a focused European network and retail business concentrating

on voice and data services. We are currently considering proposals to sell or demerge Yell, our classified advertising directories business. We also announced on 10 May 2001, a rights issue to raise approximately £5.9 billion from shareholders and that we were halting the payment of dividends for the time being. These steps combined with asset disposals, including the sale of the investments in Japan, are designed to reduce net debt in Future BT to between £15 billion and £20 billion by 31 March 2002.

### **Restructuring**

We announced in April 2000 that we would restructure our operations, by separating the UK fixed-network business into two businesses and forming four new international businesses to operate and manage BT's broadband, internet, wireless and directories businesses. The four international businesses, BT Wireless, BT Ignite, BTopenworld and Yell began operations on 1 July 2000. The BT Wholesale and BT Retail businesses were formed in October 2000.

In November 2000, we announced an intention to sell public minority stakes in some of BT's international businesses and to dispose of non-core holdings. We also stated that we expected to reduce our net borrowings from a peak of approximately £30 billion by around £10 billion. Certain of the restructuring steps have been changed to reflect developments in the capital markets. As noted above, we intend to demerge BT Wireless towards the end of 2001 and to demerge or sell Yell.

The financial impact of these proposals are illustrated in the pro forma statements on pages 133 to 140 of this document.

BT Wireless comprises the group's controlled mobile activities in the UK, Germany, Ireland and The Netherlands, and the Genie mobile internet business. The group's minority interests in wireless companies are held centrally pending clarification of their future within the BT group. The financial information on BT Wireless and the other international businesses for the 2001 financial year reflects this composition.

On 2 May 2001, we announced that we had agreed to sell our interests in Japan Telecom and J-Phones to Vodafone at a value of £3.7 billion and our interest in Airtel in Spain also to Vodafone for £1.1 billion. The overall impact of the combined transaction will be a net reduction in total BT group debt of £4.4 billion. Completion of the transactions is conditional upon relevant regulatory and procedural approvals in Europe and Japan.

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

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On 10 May 2001, we announced a rights issue, proposed to raise approximately £5.9 billion, net of expenses, of up to 1,976 million new BT shares at a price of 300 pence per share. The rights issue is due to close on 15 June 2001. Earnings (loss) and dividends per share figures in this document are stated before adjusting for the dilutionary effect of this rights issue, the exact impact of which will only be known on closing of the rights issue.

### Regulation and prices

BT 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% of BT's residential customers by bill size. This retail price control is estimated to have covered services representing about 13% of the group's turnover for the 2001 financial year. In the current price control year to 31 July 2001, BT has already reduced its prices by 1.20%, which is more than the required reduction of 1.09%. The equivalent reduction in the previous control year was 3.24%.

Most of BT's interconnect (network) charges to other UK operators are based on long-run incremental costs. There are annual reductions in these charges based on a RPI minus 8 price cap. The current network charge control regime operates until 30 September 2001. After this time it has been proposed that the broad structure of the interconnect (network) services be retained for another four years but that the "X" within the RPI minus X price-cap formula be varied between 7.5 and 13.

The Competition Commission (CC) required BT to reduce charges from a BT line to mobile phones by around 25% in the 1999 financial year and an effective annual RPI minus 7 reduction for the 2000 and 2001 financial years.

On 11 May 2001, the Office of Fair Trading issued a statement outlining the decision of the Secretary of State for Trade and Industry on the Office of Fair Trading's review of Yell's Yellow Pages business. The statement requires Yell to cap the fees charged for advertising in its UK Yellow Pages directories at RPI minus 6 for four years from January 2002. The current price cap of RPI minus 2 has been in force since 1996.

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 is required to consider the regulatory regimes in those countries.

### Competition and the UK economy

BT has a significant market share in its main UK markets for fixed-network calls and provision of exchange lines.

Competition has eroded BT's market share significantly in key market sectors, in particular areas of the UK and for certain products and services. We estimate that BT had 57% of the market for national calls in the 2001 financial year, compared with 64% and 69% in the 2000 and 1999 financial years, respectively, and supplied 83% of the exchange lines in the UK at 31 March 2001, compared with 84% and 86% at 31 March 2000 and 1999, respectively. Additionally, we estimate that BT had 71% of the market for local calls in the 2000 financial year, compared with 74% and 78% in the 2000 and 1999 financial years, respectively.

The growth in cable operators' networks in the UK is having an adverse effect on BT's share of the residential market. In recent years, BT 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.

In an environment of strong competition, BT Cellnet had 26% of the market based on the number of customer connections at 31 March 2001, compared with 27% at 31 March 2000 and 30% at 31 March 1999. There has also been a downward pressure on prices.

The group has 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's Licence was amended in April 2000 to require BT to provide other operators with use of the lines connecting BT's local exchanges to its customers and allow operators to install equipment in BT'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's results.

For its operations as a whole, BT 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's business volumes and the gross domestic product grew by 2.5% in the 2001 financial year, compared with 2.9% and 1.5% in the 2000 and 1999 financial years, respectively.

### Lines of business results

In the following commentary, we discuss the operations of the group for the 2001 financial year in terms of the new lines of business. However, as it is not practical for us to compile comparative figures for the 2000 and 1999 financial years for all the lines of business, these two earlier years are discussed in general terms in the context of the relevant line of business.

The lines of business' results for the 2001 financial year are as follows:

	Total turnover £m	Total operating profit (loss) before exceptional items and goodwill amortisation £m
BT Retail	11,813	1,004
BT Wholesale	11,493	2,540
BT Wireless	3,947	(225)
BT Ignite	3,861	(380)
Concert	2,576	19
Yell	778	210
BTopenworld	212	(296)
Other	7,151	539
Eliminations	(12,165)	-
<b>Totals</b>	<b>29,666</b>	<b>3,411</b>

The group's profits are derived predominantly from BT Retail and BT Wholesale's fixed network business in the UK. The profit from BT Wireless's mobile network in the UK is largely offset by losses being incurred in establishing its networks in Ireland, The Netherlands and Germany. Yell contributed a profit principally from its Yellow Pages directory activities in the UK. BT Ignite and BTopenworld are both in a development stage incurring losses.

#### Turnover

Group turnover, excluding BT's share of the ventures' turnover, grew by 9.1% to £20,427 million in the 2001 financial year after growing by 10.4% in the 2000 financial year compared with the 1999 financial year. The strong growth in demand for the group's products and services of approximately 9% in the 2001 financial year was partially offset by the effect of price reductions which averaged approximately 1% across the business. 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 £940 million to the growth in turnover. The transfer of certain BT businesses to the Concert global venture in January 2000 has 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 25% of the growth in group turnover. Growth in demand of approximately 11% in the 2000 financial year was partially offset by the effect of price reductions which averaged approximately 3% across the business. Both 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 BT Cellnet's mobile customer base and increased mobile usage.

The group's turnover by product is analysed as follows:

	2001 £m	2000(a) £m	1999(a) £m
Fixed-network calls	<b>5,655</b>	5,908	6,026
Exchange lines	<b>3,674</b>	3,526	3,351
Receipts from other operators	<b>2,814</b>	1,974	1,417
Wireless products	<b>2,760</b>	2,170	1,400
Private services	<b>1,091</b>	1,135	1,140
Solutions	<b>1,074</b>	915	746
Yellow Pages and other directories	<b>754</b>	642	491
Customer premises equipment supply	<b>726</b>	847	870
Other sales and services	<b>1,879</b>	1,598	1,512
<b>Group turnover</b>	<b>20,427</b>	18,715	16,953
Share of ventures' turnover	<b>9,937</b>	3,364	1,270
Trading between group and principal joint venture	<b>(698)</b>	(176)	-
<b>Total turnover</b>	<b>29,666</b>	21,903	18,223

(a) Figures for the 1999 and 2000 financial years have been restated to conform with the method of classification used in the 2001 financial year.

#### BT Retail

BT Retail's turnover is mainly derived from BT'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% to £5,655 million in the 2001 financial year following a decline of 2.0% 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% cut in fixed to mobile call prices from the end of April 1999 as required by the CC. Other reductions included enhanced discounts and lower Freefone 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% reduction in call prices following falls of 9% and 3% in the previous two years.

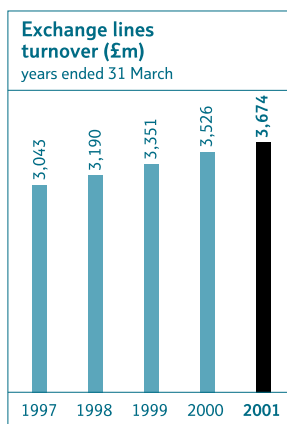
The main volume growth in fixed-network calls in the 2001 financial year was derived from a significant increase in calls to mobile phones and the increased use of the internet. In the 2000 financial year, similar factors were also behind the increase in calls over BT's fixed network. The call volume growth of 2% in

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the 2001 financial year compares with 7% 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 we attribute partly to mobile phone substitution and also to intense competition. The trend in fixed network call volumes, which we expect will continue, is illustrated in the table below:

Fixed network calls volume growth	12 months' volume growth (decline)	
	2001 %	2000 %
<b>Non-geographic calls:</b>		
Internet related and other	38	95
Fixed to mobile	30	48
<b>Geographic calls:</b>		
Local	(12)	(9)
National	(7)	(4)
International	(3)	(3)
<b>Overall</b>	<b>2</b>	<b>7</b>

Turnover from exchange lines grew by 4.2% in the 2001 financial year to £3,674 million after increasing by 5.2% 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% in the 2001 financial year and by 5.9% 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's total fixed-network lines grew by 1.3% in the 2001 financial year to 28.95 million and by 1.9% in the 2000 financial year to 28.58 million.

Private services turnover decreased by 3.9% in the 2001 financial year to £1,091 million, following a decline of 0.4% 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.

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 have been 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. We believe that this is linked to the

success of the new BT Together family of products which have now been taken up by eight million customers.

### 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 operators for interconnect services.

Turnover from receipts from other operators for interconnect charges increased by 39% in the 2000 financial year and by 43% to £2,814 million in the 2001 financial year. This turnover mainly comprises the income BT generates from other UK operators for passing calls from one operator to another and for terminating calls on BT's network. In the 1999 and 2000 financial years, it also included receipts from international operators for incoming international and transit calls which BT 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's UK competitors, particularly mobile phone operators, and the increasing level of traffic flowing through and into BT from their networks. There has been a large corresponding increase in the payments made by BT to these operators for traffic passing to their networks. Although growth has been rapid, with volumes growing at 39% for the 2001 financial year, and 38% for the 2000 financial year, BT's interconnect business does not provide the group with the same overall level of margin as its UK retail business.

In the 2001 financial year, BT Wholesale contributed an operating profit before exceptional items of £2,540 million on turnover of £11,493 million. 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%.

### BT Wireless

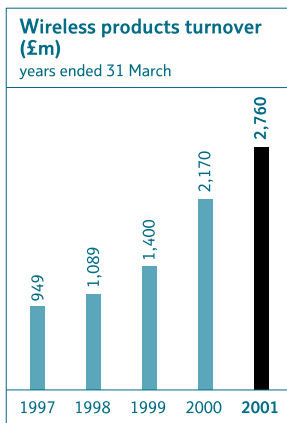
The group's wireless turnover mainly comprises calls charged to and subscriptions from BT Cellnet customers in the UK. It also includes the turnover of the three major acquired companies, Esat Digifone in Ireland since its acquisition in March 2000, Telfort's mobile activities in The Netherlands since its acquisition in June 2000 and Viag Interkom's mobile activities in Germany since its acquisition in February 2001.

Wireless turnover increased by 27% in the 2001 financial year to £2,760 million, following growth of 55% in the previous

financial year. Over three-quarters of the increase in turnover in the 2001 financial year was contributed by the three major acquisitions and nearly half of the increase in turnover in the 2000 financial year was contributed by the BT Cellnet Lumina and DX Communications businesses acquired in 1999.

Otherwise, the turnover increases in the 2001 and 2000 financial years reflected the 51% and 64% growth in BT Cellnet's customer-base in the two years, respectively, offset by the effect of reductions in mobile call prices. Nearly 3.8 million new customers were connected to BT Cellnet's network in the 2001 financial year, following the 2.9 million connected in the 2000 financial year, substantially due to the success of the "pre-paid" mobile phone introduced in the second half of the 1999 financial year. BT Cellnet had 11.2 million customer connections at 31 March 2001, of which over two-thirds were on a pre-paid basis.

BT Wireless incurred a total operating loss of £225 million before goodwill amortisation and exceptional items on total turnover of £3,947 million in the 2001 financial year. The results reflect the start up losses of the Genie wireless portal business which amounted to £138 million on turnover of £13 million. The figures directly reflect the BT Wireless business proposed to be demerged later in 2001. BT Wireless' results overall were hit by acquisition costs associated with the record customer growth in BT Cellnet and other operations.



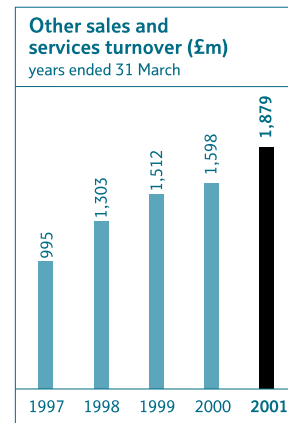
Viag Interkom incurred an operating loss of £41 million before goodwill amortisation and exceptional items, for BT Wireless, on turnover of £70 million from 20 February 2001, the date of acquisition. The exceptional items attributable to BT Wireless include £2,800 million of the Viag Interkom goodwill impairment charge.

#### BT Ignite, BTopenworld and other

Turnover from the external sales of BT Ignite Solutions and Syntegra, which provides outsourcing and systems integration services, both in the UK and worldwide has grown by 17.4% in the 2001 financial year to £1,074 million after growing by 23% in the 2000 financial year. The reduction in the growth in turnover in the 2001 financial year is attributable to the transfer of activities to the Concert global venture in January 2000.

Turnover from BT's other sales and services has grown by 17.6% in the 2001 financial year to £1,879 million after growing by 5.7% in the 2000 financial year. The turnover in the 2001

financial year included the fixed-network business of Telfort, Esat and Viag Interkom since acquisition. Videoconferencing, and broadcasting and other multimedia services, contributed strongly to the growth in turnover. This category also included sales by Concert Communications up to early January 2000 before its transfer to the new Concert joint venture.



BT Ignite's turnover in the 2001 financial year was £3,861 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 business, 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 first time in this financial year, including Esat, Telfort and Viag Interkom, amounted to a total of £135 million.

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 and continental European narrowband internet access products. Narrowband activities contributed approximately 50% of the operating loss whilst our broadband services make up around 40% reflecting the start-up nature of the businesses. It is our aim to achieve narrowband EBITDA break-even by the end of the 2003 financial year. The broadband business is expected to follow shortly afterwards. To do this, we have already put in place various cost cutting measures which include the reduction of headcount by 20% following a recent reorganisation. We are also exiting loss making legacy contracts and rationalising our numerous e-mail platforms.

#### Yell

BT's Yellow Pages and other directory businesses include the Yellow Book USA business acquired in August 1999. Turnover of £754 million has grown by 17.4% in the 2001 financial year, substantially due to this acquisition. Turnover grew by 31% in the 2000 financial year, of which two-thirds is due to the acquisition. Turnover in the UK business was broadly unchanged in the 2001 financial year in contrast to the 2000 financial year when the UK business grew by about 9%, partly reflecting the good growth in the economy.

Yell contributed an operating profit of £210 million before goodwill amortisation on turnover of £778 million. The results include its US operations in its first full year.

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### Total turnover

Total turnover in the 2001 financial year of £29,666 million includes BT's proportionate share of its ventures' turnover of £9,937 million before adjusting for trading between the Concert joint venture and the BT group. This total turnover grew by 35% in the 2001 financial year after growing by 20% in the 2000 financial year compared with the total turnover in the 1999 financial year. BT's acquisitions of businesses and interests in new ventures in North America, Europe and Asia Pacific, including Concert from January 2000, accounted for around three-quarters of the increase in total turnover in the 2001 financial year and around a half of the increase in total turnover in the 2000 financial year.

### Other operating income

As part of the arrangements for the establishment of Concert, BT 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 increased by 35% in the 2001 financial year to £20,759 million after increasing by 15.4% in the 2000 financial year. As a percentage of group turnover, operating costs, excluding goodwill amortisation, increased from 79% in the 1999 financial year to 82% in the 2000 financial year and to 85% in the 2001 financial year. In all three financial years, net exceptional costs were incurred. These amounted to £2,857 million, £111 million and £69 million in the 2001, 2000 and 1999 financial years, respectively. These exceptional costs are considered separately in the table below and the discussion which follows.

	2001 £m	2000 £m	1999 £m
Staff costs	4,625	4,283	3,871
Own work capitalised	(693)	(498)	(428)
Depreciation	3,045	2,704	2,568
Goodwill and other intangibles amortisation	386	89	–
Payments to telecommunication operators	3,802	3,068	2,106
Other operating costs	6,737	5,602	5,119
<b>Total operating costs before exceptional costs</b>	<b>17,902</b>	<b>15,248</b>	<b>13,236</b>
Exceptional costs	2,857	111	69
<b>Total operating costs</b>	<b>20,759</b>	<b>15,359</b>	<b>13,305</b>

Staff costs increased by 8.0% in the 2001 financial year to £4,625 million, after rising by 10.6% in the 2000 financial year.

In the 2001 financial year, the numbers employed in the group increased by 200 to 137,000 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. Over 7,500 people joined through the acquisitions of Viag Interkom and Telfort. 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 group increased by 12,100. This net increase included 5,000 individuals employed outside the UK mainly through acquisitions, 2,500 former agency workers now working for BT, 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 allocation for the employee share ownership scheme, included within staff costs, was £32 million in the 2001 financial year. This represents 2% of the pre-tax profit for the year, before the exceptional goodwill impairment charges and the gains made on certain disposals. The allocation for the 2000 financial year was £59 million and represented 2% of pre-tax profit for that year. The allocation for the 1999 financial year of £64 million represented 2% of pre-tax profit for that year, before the gain on the sale of MCI shares.

The depreciation charge increased by 12.6% in the 2001 financial year to £3,045 million after increasing by 5.3% in the 2000 financial year, reflecting BT's continuing high level of investment in its networks and, in the 2001 financial year, the acquisition of its new businesses.

Goodwill amortisation in respect of subsidiaries and businesses acquired since 1 April 1998, when BT adopted FRS 10, and amortisation of other intangibles amounted to £386 million in the 2001 financial year compared with £89 million in the 2000 financial year. Of the total in the 2001 financial year, £150 million relates to the BT Cellnet minority acquisition in November 1999 and £93 million relates to the Esat group acquisition in March 2000.

Payments to other telecommunication operators grew by 24% in the 2001 financial year to £3,802 million after increasing by 46% 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'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's outgoing international calls from early January 2000 and those made by BT to international operators for outgoing and transit calls prior to that time. Also included are payments made to mobile

phone operators on behalf of BT Cellnet Lumina and DX Communications' customers.

Other operating costs, which rose by 20% in the 2001 financial year to £6,737 million and by 9.4% 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. The costs incurred in supporting the high growth of BT Cellnet was the main factor behind the increase in costs in the 2000 financial year. Also, 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.

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

The exceptional items within operating costs are summarised in the table in the adjacent column. The most significant item in the 2001 financial year is the impairment of goodwill in Viag Interkom. We completed the acquisition of the 55% interest in the company for £8,770 million 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. We have undertaken an impairment review 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.

Exceptional operating costs	2001 £m	2000 £m	1999 £m
Impairment of goodwill in Viag Interkom	3,000	-	-
Write off of Viag Interkom's IT systems	43	-	-
Infrastructure rates refunds	(193)	-	-
Write off of cellular subscriber acquisition costs	7	-	-
Costs relating to the disengagement from MCI	-	64	69
Costs relating to the closure of the BT Cellnet analogue network	-	47	-
<b>Total exceptional costs</b>	<b>2,857</b>	<b>111</b>	<b>69</b>

An impairment in goodwill of £3,000 million resulted from this review.

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;
- a credit of £193 million for the refund of rates on BT's infrastructure following a successful legal action taken by BT in 2000 to challenge the rateable valuations on which it was charged for its network assets.

The exceptional costs for the 2000 financial year included £47 million for the exit of BT Cellnet's analogue network in autumn 2000. Additionally, in the 2000 and 1999 financial years, costs of £64 million and £69 million, respectively, involved in the work to ensure that BT'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 will be sought and initiatives to reduce costs totalling approximately £575 million have been identified.

#### Group operating profit

Group operating profit for the 2001 financial year of £61 million was £3,537 million lower than in the previous year, principally due to the £3,000 million goodwill impairment charge. The profit for the 2000 financial year was £218 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 13.3% lower than in the 2000 financial year. This, in turn, was 2.2% 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

## Financial review

£298 million incurred by our 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. We expect the factors experienced in the 2001 financial year to continue.

### Associates and joint ventures

The results of associates and joint ventures by line of business for the 2001 financial year are as follows:

	Share of turnover £m	Share of operating profit (loss) before exceptional items and goodwill amortisation £m
BT Wireless	539	(228)
BT Ignite	391	(119)
Concert	2,576	19
BTopenworld	45	(69)
Japanese and other investments	6,386	517
	9,937	120

BT Wireless's ventures comprised BT's mobile interests in Germany and The Netherlands until their full acquisition. BT Ignite's ventures comprise BT's fixed and data networks in those areas. Concert is the global joint venture with AT&T launched in January 2000. BTopenworld's ventures comprise new and developing internet operations in the UK, Spain and Italy. BT Retail, BT Wholesale and Yell do not have any significant associates or joint ventures.

BT's share of its ventures' turnover rose from £1,270 million in the 1999 financial year to £3,364 million in the 2000 financial year and to £9,937 million in the 2001 financial year, including sales by the principal venture to BT. This growth was due to our establishment and acquisition of interests in ventures in North America, Europe and Asia Pacific over the past three years. Acquisitions of interests contributed £6,133 million of the growth in the 2001 financial year and £1,229 million of the growth in the 2000 financial year. In the 2001 financial year, £9,677 million of the total arose from ventures located outside the UK, compared with £3,164 million in the 2000 financial year and £1,149 million in the 1999 financial year. The principal contributors in the 2001 financial year were Japan Telecom and J-Phone (£4,542 million), Concert (£2,576 million), Cegetel (£860 million), Viag Interkom (£449 million to February 2001), Airtel (£286 million) and LG Telecom (£281 million). The main contributors in the 2000 financial year were Cegetel (£727 million), Concert (£583 million from January 2000), Japan Telecom (£501 million from September 1999), Viag

Interkom (£296 million), Airtel (£250 million) and a full year's contribution from LG Telecom (£200 million). In the 1999 financial year, the main contributors were Cegetel (£578 million), Airtel (£157 million), Viag Interkom (£82 million) and LG Telecom (£81 million from October 1998).

The group's share of its ventures' operating losses totalled £12 million in the 2001 financial year, before £385 million goodwill amortisation and impairment. The results included an exceptional write off of £132 million for subscriber acquisition costs. The comparable losses, before goodwill amortisation, amounted to £316 million in the 2000 financial year and £325 million in the 1999 financial year. The underlying improvement in the 2001 financial year was mainly due to the investment in the J-Phone companies in May 2000.

The principal loss 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's share of these losses was £277 million (for 11 months), £240 million and £193 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 fixed and mobile 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 our interest was diluted in June 2000. BIB launched its new Open interactive digital TV service in the UK in autumn 1999 after a period of development. Ventures returning operating profits in the 2001 financial year mainly comprised Japan Telecom and J-Phone, together with Concert, Cegetel in France, Airtel in Spain, and Maxis Communications in Malaysia. We have agreed in principle to sell our interest in Maxis.

BT's share of the operating profits of Japan Telecom and J-Phone totalled £473 million before goodwill amortisation, interest, tax and minority interests deductions, in the 2001 financial year. This profit was mainly derived from BT's investment in the J-Phone companies which was made in May 2000. After goodwill amortisation, interest, tax and minority interest deductions, the profit attributable to BT shareholders amounted to £39 million for the 2001 financial year. Shortly before the 2001 financial year end, BT reduced its economic interest in the J-Phone companies and after the year-end reduced its direct interest in Japan Telecom. We have now agreed to sell these investments.

We have aligned the accounting of all the BT Wireless operating units during the 2001 financial year; this has resulted in an exceptional write off of previously capitalised costs in certain non-UK operations of which £132 million related to deferred subscriber acquisition costs in the ventures.

Concert's operating profit before goodwill amortisation and exceptional items attributable to BT was £19 million for the 2001 financial year on our 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. The 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. BT and AT&T are discussing various options relating to Concert, including ways to improve the performance of the business and strengthen the scope of the relationship and various strategic alternatives to the Concert joint venture. See "Discussions with AT&T regarding Concert and BT Ignite" on page 17.

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, Airtel, Cegetel, Japan Telecom 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 joint venture since October 1998.

Goodwill amortisation has been increasing as a result of new acquisitions in ventures. In the 2001 financial year, the charge totalled £185 million compared with £84 million in the 2000 financial year and £17 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 we have not made any major acquisitions of interests in ventures since May 2000. We consider that goodwill arising in Asian ventures became impaired during the 2001 financial year, and we have incurred an exceptional impairment charge of £200 million.

As a consequence of the termination of the BT/MCI merger agreement and the then-prospective MCI/WorldCom merger, BT ceased treating MCI as an associate on 31 October 1997, although we held the investment until its sale to WorldCom in September 1998.

#### **Total operating profit (loss)**

Total operating loss for the 2001 financial year was £336 million, including BT's share of the operating results of its ventures. This was a decrease of £3,534 million compared with the operating profit in the 2000 financial year and was principally due to the £3,200 million goodwill impairment charges. The profit for the 2000 financial year had decreased by

£276 million over the 1999 financial year. Before goodwill amortisation and exceptional items, total operating profit for the 2001 financial year was 2.0% lower than that in the previous financial year, which was 2.2% lower than the result for the 1999 financial year. The decline in the underlying total operating profit in the 2001 and 2000 financial years were due to the factors explained above.

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

We sold our 34% 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 our aeronautical and maritime interests, the sale of an interest in I.Net by way of a public offering, the reduction of our equity interest in BIB to below 20% and the sale of minor equity investments.

Following the completion of the MCI/WorldCom merger in September 1998, BT 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'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, £1,044 million arises in the BT group for the 2001 financial year, compared with £306 million and £261 million in the 2000 and 1999 financial years, respectively.

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. There has also been a £194 million increase in BT's share of its ventures' interest charges principally through the Japanese investments and Viag Interkom. The group's net interest charge has benefited in the year by an exceptional interest receipt of £25 million relating to the rates refund from the UK Government, noted above.

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The higher total interest charge in the 2000 financial year over the previous year was due to an increase in BT's share of its ventures interest costs and the cost of funding the acquisitions made by BT during the 2000 financial year, including the BT Cellnet minority acquisition.

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. We expect the net interest charge 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 to be offset in part by the expected proceeds of the rights issue and the sales of investments already announced.

### 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. Before exceptional items and goodwill amortisation, profit before taxation in the 2001 financial year of £2,072 million was 33% lower than the comparable profit in the 2000 financial year. This was 5.3% lower than in the 1999 financial year. The significantly lower underlying profit in the 2001 financial year was chiefly due to the higher interest charges,

explained above. The lower profit in the 2000 financial year was due to the lower group operating profit and higher interest charges, also 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% of profit before taxation and goodwill impairment. This compares with a tax charge of 30.5% for the 2000 financial year and 30.1% for the 1999 financial year. The 2001 and 2000 effective tax rates compare with the standard 30% 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% 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% rate of corporation tax set 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

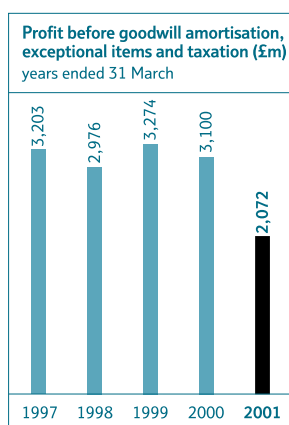
Basic loss per share, based on the loss for the 2001 financial year of £1,810 million, were 27.7 pence. Earnings per share for the 2000 and 1999 financial years were 31.7 pence and 46.3 pence, respectively. Earnings before goodwill amortisation and exceptional items were 20.5 pence per share for the 2001 financial year, in comparison with 34.2 pence for the 2000 financial year and 35.0 pence for the 1999 financial year. Diluted earnings per share are not materially different.

The dividend for the 2001 financial year of 8.7 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 has decided that there will 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. Future dividend policy will be decided by the individual listed companies, taking into account their respective capital structure, cash requirements and the markets in which they operate. The board expects that Future BT will recommence a final dividend in respect of the 2002 financial year.

BT paid or recommended dividends of 21.9 pence per share for the 2000 financial year and dividends of 20.4 pence per share in respect of the 1999 financial year.

### Financing

Net cash inflow from 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 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.

HM 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 was mainly 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 our European ventures. We paid the consideration of £856 million for the completion of the Esat Digifone minority acquisition 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, we do not intend to pay any equity dividends in the 2002 financial year.

The resulting cash outflow, before liquid resources and financing, of £19,127 million for the 2001 financial year was funded by our issuing substantial amounts of long-term debt instruments and drawing on our medium-term notes programmes. In December 2000, we 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, we 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, we issued a twenty five-year £250 million index-linked Eurobond.

Summarised cash flow statement	2001 £m	2000 £m	1999 £m
Net cash inflow from operating activities	5,887	5,849	6,035
Dividends from associates and joint ventures	10	5	2
Net cash outflow for returns on investments and servicing of finance	(727)	(163)	(328)
Taxation paid	(669)	(1,311)	(630)
Net cash inflow (outflow) for capital expenditure and financial investment	(8,442)	(3,752)	1,046
Net cash outflow for acquisitions and disposals	(13,754)	(6,405)	(1,967)
Equity dividends paid	(1,432)	(1,364)	(1,186)
Cash inflow (outflow) before management of liquid resources and financing	(19,127)	(7,141)	2,972
Management of liquid resources	(480)	1,236	(2,447)
Net cash inflow (outflow) from financing	19,735	5,959	(458)
Increase in cash in the year	128	54	67
Decrease (increase) in net debt in the year	(18,942)	(6,582)	3,146

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We 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, we 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% at 31 March 2001, compared with 53% 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 our intention, expressed at the end of the 2000 financial year, to refinance a significant part of our 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% index-linked Eurobond repayable in 2025. In December 2000, we issued four series of notes comprising US\$2.8 billion 8.625% thirty-year notes, US\$3.0 billion 8.125% ten-year notes, US\$3.1 billion 7.625% five-year notes and US\$1.1 billion three-year floating rate notes. In February 2001, we issued six series of notes comprising £700 million 7.5% sixteen-year notes, €2.25 billion 6.875% ten-year notes, €3.0 billion 6.125% six-year notes, £400 million 7.125% six-year notes, €1.75 billion 5.625% 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% Eurobond repayable in 2028 and, in October 1999, a US\$1.0 billion five-year 6.75% 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 is proposed to raise approximately £5.9 billion, after expenses, which, together with the cash from disposals already announced, should allow us to meet our debt reduction target of £10 billion by December 2001. Any debt assumed by Yell or BT Wireless on demerger or proceeds received from the sale of Yell will further contribute to debt reduction. We expect net debt to increase as a result of net cash outflows from our planned capital expenditure and interest payments even after taking into account the restructuring plans. However, our target is now to reduce net debt in Future BT to between £15 billion and £20 billion by 31 March 2002.

### Treasury policy

The group has a centralised treasury operation which will remain following the progressive devolution of the group's operations. Its primary role is to manage liquidity, funding, investment and the group's financial risk, including risk from volatility in currency and interest rates and counterparty credit risk. The treasury operation is not a profit centre and the objective is to manage risk at optimum cost.

The Board sets the treasury department's policy and its activities are subject to a set of controls commensurate with the magnitude of the borrowings and investments under its management. Counterparty credit risk is closely monitored and managed within controls set by the Board. Derivative instruments, including forward foreign exchange contracts, are entered into for hedging purposes only.

We have set out further details on this topic and on our capital resources and foreign currency exposure in note 35 to the financial statements in compliance with FRS 13.

### Capital resources

During the 2001 financial year, the group has increased its level of borrowings so that its net debt was £28 billion at 31 March 2001 and £29 billion at the end of April 2001. We have stated our intention to reduce net debt in Future BT to between £15 billion and £20 billion by 31 March 2002. This debt reduction is dependent on our being successful in completing our rights issue and the sales of investments already

announced. If we are unsuccessful in our plans either in part or in whole, there is a risk that our credit rating will be further downgraded and if this happens we may lose some financial flexibility in our ability to raise short-term finance for our operational needs.

The directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future and therefore they continue to adopt the going-concern basis in preparing the financial statements.

There has been no significant change in the financial or trading position of the group since 31 March 2001, other than the announcement of the rights issue and the planned Japanese and other investment disposals described above, and the completion of the Esat Digifone minority interest purchase in April 2001.

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.

#### **Foreign currency and interest rate exposure**

Most of the group's current turnover is invoiced in pounds sterling, and most of its operations and costs arise within the UK. The group's foreign currency borrowings, which totalled £24.9 billion at 31 March 2001, are used to finance its operations. Of these borrowings, approximately £19.1 billion was swapped into sterling. 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 investment, interest expense, purchase and sale commitments. The commitments hedged are principally US dollars, the euro and the yen. As a result of these policies, the group's exposure to foreign currency arises mainly on the residual currency exposure on its non-UK

investments in its subsidiaries and ventures and on any imbalances between the value of outgoing and incoming international calls with Concert. To date, these imbalances have not been material. As a result, the group's profit has not been materially affected by movements in exchange rates, with the exception of the second half of the 1999 financial year when we had a large US dollar position with the short-term investments resulting from the MCI proceeds. We progressively closed out this exposure in the period to 31 March 1999 as the US dollar strengthened against sterling and, as noted above, we recorded a gain of £87 million, which was included in the profit for the 1999 financial year.

The majority of the group's long-term borrowings has been, and is, subject to fixed interest rates. The group has entered into interest rate swap agreements with commercial banks and other institutions to vary the amounts and period for which interest rates are fixed. At 31 March 2001, the group had outstanding interest rate swap agreements with notional principal amounts totalling £9,574 million. At 31 March 2000, the group had outstanding interest rate swap agreements and gilt locks (based on forward sales of HM Government treasury stock) with notional principal amounts totalling £2,073 million.

The long-term debt instruments issued in December 2000 and February 2001 both contain covenants that if the BT group credit rating is downgraded below A3 in the case of Moody's or below A minus in the case of Standard & Poor's, 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, BT's annual interest charge would increase by £65 million if BT's credit rating was to fall by one credit rating category by both agencies below a long-term debt rating of A3/A minus. In May 2001, Moody's downgraded BT's credit rating to Baa1, which will increase BT's annual interest charge by £32 million. Our credit rating from S&P's is A minus.

The greater use of floating rate debt in the 2001 and 2000 financial years has increased the group's sensitivity to changes in short-term sterling interest rates. Based upon the composition of net debt at 31 March 2001, a one percentage point increase in interest rates would increase the group's annual net interest expense by less than £90 million. Based upon the composition of net debt at 31 March 2000, a one percentage point increase in interest rates would have increased the group's annual net interest expense by less than £55 million. This compares with a decrease in the annual net interest expense of £35 million based on the composition of net debt at 31 March 1999 using the same variation in interest rates. The greater effect over the 2000 financial year is due to the increase

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in BT's floating rate borrowings. The change in effect during the 2000 financial year was due to the change from an excess of short-term investments over short-term borrowings at the beginning of the 2000 financial year to an excess of short-term borrowings over short-term investments at its end.

The group's exposure to changes in currency rates has increased following significant investment in Germany. A 10% strengthening in sterling against major currencies would cause the group's net assets at 31 March 2001 to fall by less than £1,200 million, with insignificant effect on the group's profit. This compares with a fall of less than £500 million in net assets based on the group's net assets at 31 March 2000 using the same variation in currency rates. The increase in effect of currency movements over the year was due to the greater proportion of the group's net assets deployed in non-UK countries following its significant investments in Germany and other European countries in the year. Because foreign exchange contracts are entered into as a hedge of sales and purchases, a change in the fair value of the hedge is offset by a corresponding change in the value of the underlying sale or purchase.

### Capital expenditure

Capital expenditure on plant, equipment and property totalled £4,986 million in the 2001 financial year, compared with £3,680 million in the 2000 financial year and £3,269 million in the 1999 financial year. Of the total capital expenditure, £4,260 million, £3,287 million and £3,005 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. We had installed ADSL equipment in 839 UK exchanges by the end of the 2001 financial year as the continuation of our plan to roll out this equipment to all our major local exchanges. We are 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. BT Cellnet has continued improving the quality and capacity of its digital GSM network. Of the capital expenditure outside the UK, £632 million was concentrated in

Europe in the 2001 financial year following our acquisition of Esat, Telfort and Viag Interkom in building out their networks. 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. Assets in course of construction increased in the 2001 financial year by £733 million to £1,966 million at 31 March 2001. The increase reflected the acquisition of businesses in the year, BT Cellnet's continuing construction of its networks and further expenditure on ADSL.

As already discussed, in April 2000, we purchased one of the five 3G licences in the UK Government's auction for £4.03 billion, which we paid in May 2000. This 20-year licence should enable BT, coupled with our existing GSM spectrum, to deliver the next generation mobile multimedia service to its customers. A third generation mobile licence in The Netherlands was awarded to Telfort in July 2000 for £267 million.

The group expects capital expenditure in the 2002 financial year to be around £4.9 billion, of which £1.5 billion would be incurred by BT Wireless. We anticipate BT Wholesale's capital expenditure will be £2 billion per annum and BT Ignite's to be £1 billion per annum. Contracts placed for ongoing capital expenditure totalled £1.2 billion at 31 March 2001. We plan to continue to spend on our IP backbone network, in providing web hosting facilities and continuing the expansion of our networks to meet the projected broadband demand. We also intend building the new third generation wireless networks in the UK, Germany, The Netherlands and Ireland. We are focusing capital expenditure on projects with higher and more immediate financial returns. BT expects that future capital expenditure will be provided from net cash inflows from operating activities, our rights offering 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, we 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, we guaranteed bank loans to that group totalling £782 million at 31 March 2001. As noted above, we have now agreed to sell our interests to Vodafone for £3.7 billion. As part of this transaction, BT will exercise options to buy just under 5% of the shares in each of the three regional J-Phone operating companies from Japan Telecom for a total of £380 million.

In June 2000, we acquired for £1,207 million our partner's 50% interest in Telfort, the communications joint venture which we 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, we acquired the 55% interest in Viag Interkom that we did not already own under agreements made in August 2000. In January 2001, we acquired a 10% interest from Telenor for £1,611 million, including its share of the German third generation licence and in February 2001, we acquired the remaining 45% 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, we have carried out impairment reviews of the carrying values of Viag Interkom and our other major wireless interests. As discussed above, we have 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, we acquired the 49.5% interest in Esat Digifone that we did not already own, also from Telenor, for £856 million under an agreement made in early 2000.

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, we completed the acquisition of the 40% 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% interest in Japan Telecom for £1,254 million in August 1999, with BT having an economic interest of 20%. Concurrent with this transaction, BT sold its Japanese subsidiary to Japan Telecom. Goodwill arising on the interest of Japan Telecom of £432 million is being amortised over a 20-year period. As already mentioned, Vodafone has acquired AT&T's interest and, on completion, our interest in Japan Telecom will be through a simple 20% direct investment in the company pending the sale to Vodafone.

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

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 have been made causing a downward adjustment of £49 million to the unrealised profit which has been recognised in this year's statement of recognised gains and losses.

In August 1999, we completed the acquisition of the Yellow Book USA classified directory advertising business based in New York for a total consideration of £415 million. In the same month, we acquired Control Data Systems (renamed Syntegra (USA)), a US-based e-commerce and systems integration company, for £213 million. In May 1999, we acquired a 20% 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, we acquired control of Esat Telecom Group (Esat) at the end of March 2000, following regulatory clearance. We paid the majority of the consideration of £1,558 million in April 2000 after the 2000 financial year end. This Irish communications group held a 49.5% interest in Esat Digifone, Ireland's second largest mobile phone operator. We acquired a further 1% in this company in January 2000, so it also became part of the BT group 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% interest which we acquired in April 2001.

In the 1999 financial year, BT acquired from MCI its 24.9% 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.

In March 1999, the group, through its then 60%-owned subsidiary BT Cellnet, completed the acquisition of Martin Dawes Telecommunications Holdings (MDT) (renamed BT Cellnet Lumina), then the largest independent mobile telecommunication services provider in the UK. The consideration totalled approximately £130 million, of which £90 million was deferred. In December 1999, an additional £27 million was paid in acquiring a minority interest in MDT's

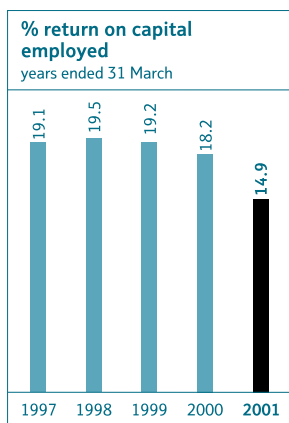
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main operating subsidiary. Goodwill of £186 million arose on this combined acquisition and is being amortised over 10 years.

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% stake in Maxis Communications of Malaysia was acquired for £279 million and a 23.5% 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).

### Return on Capital Employed

The group made a return before goodwill amortisation and impairment of 14.9% on the average capital employed in its business excluding goodwill, on a historical cost basis, in the 2001 financial year, compared with returns of 18.2% and 19.2% in the 2000 and 1999 financial years, respectively. The declining returns reflect the reduced margins earned in an increasingly capital intensive business.



### 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% 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 HM 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 has been 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% of employees' pensionable pay for the 2001 financial year compared with 9.5% of pay during each of the two previous financial years under review. In addition, the company paid special 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 special 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.

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% 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 if permission to appeal is given.

A further actuarial valuation of the BTPS at 31 December 2000 is under consideration. This is in advance of the normal three-yearly valuation and is being considered in light of the high level of redundancies since the December 1999 valuation, the fall in global equity markets in 2000 and the early part of 2001 and the current restructuring of the group.

The BTPS was closed to new entrants on 31 March 2001 and we have set up a new defined contribution pension scheme 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 costs in the longer term.

#### **Property**

We are in negotiations with Land Securities Trillium and the William Pears Group, for their joint venture company to provide property services to BT. We are planning to grant long leases on much of our specialised properties to that company and to lease back these properties on a short-term basis. In the process, we expect to receive a significant cash sum which will go towards reducing our borrowings. We anticipate that the transaction will be completed during the first half of the 2002 financial year. The main continuing impact on our results from this transaction is expected to be an increase in operating lease rental expenses, partly offset by the beneficial impact on our interest costs and depreciation charges.

#### **Impact of inflation**

In accordance with a requirement of BT's main licence, the group's annual accounts for the 2000 financial year prepared on a current cost basis were published in September 2000. These accounts showed that the group's current cost profit before tax was £2,189 million, compared with £2,942 million under the historical cost convention. The group's current cost total assets at 31 March 2000 were £40,408 million, compared with £37,588 million in its historical cost accounts. These current cost accounts are no longer required to be published following a licence amendment.

#### **Environment**

When removing old analogue exchange equipment from buildings, BT recycles the metal content and takes special care to properly dispose of any hazardous materials. Although BT receives proceeds from the sale of recovered materials, this is more than offset by the cost of dealing with hazardous materials, contracting and planning their removal and preparing the released site for further development. BT believes that the total cost of dealing with these hazardous materials will not be significant.

#### **Geographical information**

In the 2001 financial year, approximately 91% of the group's turnover was generated by operations in the UK, compared with 95% in the 2000 and 96% in the 1999 financial years. Including BT's proportionate share of its ventures, which are mainly located outside the UK, 62% of total turnover was generated in the UK, compared with 82% in the 2000 financial year and 90% in the 1999 financial year. BT's operating profits have been derived from its UK operations with losses being incurred outside the UK in each of the last three financial years.

#### **Regulatory financial information**

BT is required under its main licence to publish disaggregated financial information for various activities of the group, which have been used as the basis of charges paid by other telecommunication operators in the UK for the use of BT's network. The activities presented separately in the regulatory financial statements do not necessarily correspond with any businesses separately managed, funded or operated within the group. The results set out in these statements for the 2000, 1999 and 1998 financial years showed that the group's operating profit is derived predominantly from fixed-network calls, after taking account of an operating deficit arising on the provision of exchange lines.

#### **New UK accounting standards**

Under a new UK accounting standard FRS 19 – Accounting for deferred tax, we are required to provide for deferred tax on a full liability basis from 1 April 2001, in place of the existing requirement to provide only for that deferred tax which we consider we shall be paying in the foreseeable future. The impact of this new standard will reduce our distributable reserves by approximately £2 billion. The adverse impact of the standard on our annual profit after tax is estimated at around £60 million and 0.9 pence reduction in our earnings per share. If this new standard had been adopted on 31 March 2001, our gearing would be standing at 220% in place of the 192% under current accounting policies. This new accounting

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standard has no effect on the actual corporation tax we shall pay or on our cash flows. The standard allows companies to discount their deferred tax liabilities. We do not intend to adopt 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. We are required to adopt fully this new standard by our 2004 financial year. We expect this standard will have the effect of increasing the pension costs to be included in operating costs, thus reducing our operating profit, but this will be offset in part by our stated financing costs being reduced. Pension fund actuarial gains and losses, including investment returns varying from the assumed returns, will be recorded in full in our statement of recognised gains and losses annually. Pension fund deficits, calculated in accordance with prescribed rules in the standard, will be shown in our balance sheet as will any surpluses to the extent we expect to obtain value from them in the foreseeable future.

### Economic and Monetary Union (EMU)

On 1 January 1999, a new currency, the euro, was introduced into the European Union as part of EMU. Twelve member states have established fixed conversion rates between their existing currencies and the euro. The currencies of these participating member states now exist only as subdivisions of the euro. It is expected that these national currencies will be withdrawn on 31 December 2001 and that all notes and coins in these currencies will cease to be valid tender by 1 June 2002.

Most of the group's business in Europe is conducted in the UK, which is not one of the 12 participating member states. Government policy on UK membership of the single currency was set out by the Chancellor of the Exchequer in a statement to the House of Commons in October 1997, as restated by the Prime Minister in February 1999 on the launch of the first Outline National Changeover Plan. The determining factor underpinning any Government decision on membership of the single currency is whether the economic case for the UK joining is clear and unambiguous. Because of the magnitude of the decision, HM Government believes that, whenever the decision to enter is taken, it should be put to a referendum of the British people. The Government has said that it will produce an assessment of five relevant economic tests early in the next parliament, which commences in June 2001, and that both Government and business should make active preparations to give the UK the genuine option to decide to join.

BT has established a steering group, with representatives from across each of the lines of business and supporting group functions, to review the impact of the introduction of EMU. A project team acts as a co-ordination point to ensure consistency of approach across the group and that plans are in place to meet agreed business strategy on EMU.

The group carries on business in certain of the participating member states and is continuing to take appropriate steps to adapt its operations to use the euro.

BT is considering the impact of EMU on the UK business and the associated costs.

### US GAAP

The group's net income (loss) and earnings (loss) per share for the three financial years ended 31 March 2001 and shareholders' equity at 31 March 2001 and 2000 under US Generally Accepted Accounting Principles (US GAAP) are shown further in the United States Generally Accepted Accounting Principles Section (see Consolidated financial statements). Differences between UK GAAP and US GAAP include results of the differing accounting treatment of pension costs, redundancy costs, intangible assets, goodwill, deferred taxation, capitalisation of interest, financial instruments, contributing assets to joint ventures, stock compensation, directories in progress and dividends. Cash flow information under the US GAAP presentation is also shown further in this document.

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities as amended by SFAS No. 137 and SFAS No. 138, became effective for BT on 1 April 2001. SFAS No. 133, which requires the group to record all derivatives on the balance sheet at fair value, introduces new rules in respect of hedge accounting and the recognition of movements in fair value through the income statement. BT expects that it will not designate any of its derivative instruments as qualifying hedge instruments under SFAS No. 133 and, accordingly, the group expects to record changes in the fair value of its derivative instruments in current earnings each period. The group expects that the one-time pre-tax charge for the initial adoption of SFAS No. 133 to be recorded against US GAAP income will not be material. The group expects to record an unrealised pre-tax loss of approximately £143 million in shareholders' equity for the quarter ending 30 June 2001. These transition adjustments will be calculated using the assumption that none of the hedging relationships that existed prior to the adoption of SFAS No. 133 will qualify for hedge accounting after the adoption of SFAS No. 133. At this time, the group plans no significant change to its risk management strategies due to the adoption of SFAS No. 133.