Financial Results

DC10-279 11 November 2010

BT GROUP PLC

RESULTS FOR THE SECOND QUARTER AND HALF YEAR TO 30 SEPTEMBER 2010

BT Group plc (BT.L) today announces its results for the second quarter and half year to 30 September 2010. Unless otherwise stated, the changes in results are year on year against the second quarter or half year to 30 September 2009.

Key points for the second quarter:

- Adjusted revenue[1] of £4,977m, down 3%
- Adjusted EBITDA[1] of £1,452m, up 3%
- Adjusted profit before tax[1] of £496m, up 13% (reported profit before tax of £406m, up 48%)
- Adjusted earnings per share[1] of 5.1p, up 16% (reported earnings per share down 7% due to prior year tax credit)
- Free cash flow[2] of £535m; £950m in the half year, up 63%
- Net debt[2] of £8.7bn, down by £1.2bn
- Interim dividend of 2.4p per share, up 4%
- 2010/11 full year outlook raised:
    - adjusted EBITDA[1] expected to be around £5.8bn
    - free cash flow[1] expected to be £2bn
- Free cash flow[1] in 2011/12 and 2012/13 expected to be above £2bn

Ian Livingston, Chief Executive, commenting on the results, said:

"We have made significant progress in improving profitability and cash flow, enabling us to invest in building the foundations for revenue growth in 2012/13.

"We have increased our EBITDA outlook for the year and now expect to hit our £2bn free cash flow target two years early.

"Global Services order intake was up 50% at £2.1bn. Our fibre roll out has passed three million premises and BT Infinity orders are now running at over 4,000 per week. BT Vision customers now stand at more than half a million, with more developments planned to enhance our offering. Our share of DSL broadband net additions was 45%, one of our highest shares ever."

[1] Before specific items. Specific items are defined on page 18
[2] Free cash flow and net debt are defined on page 20

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RESULTS FOR THE SECOND QUARTER AND HALF YEAR TO 30 SEPTEMBER 2010

Group results

	Second quarter to 30 September			Half year to 30 September		
	2010	2009	Change	**2010**	2009	Change
	£m	£m	%	**£m**	£m	%
Revenue						
- adjusted[1]	**4,977**	5,122	(3)	**9,983**	10,357	(4)
- reported	**4,977**	5,070	(2)	**9,983**	10,305	(3)
EBITDA						
- adjusted[1]	**1,452**	1,415	3	**2,851**	2,741	4
- reported	**1,381**	1,309	6	**2,729**	2,594	5
Operating profit						
- adjusted[1]	**715**	656	9	**1,385**	1,244	11
- reported	**644**	550	17	**1,263**	1,097	15
Profit before tax						
- adjusted[1]	**496**	440	13	**942**	822	15
- reported	**406**	275	48	**781**	547	43
Earnings per share						
- adjusted[1]	**5.1p**	4.4p	16	**9.5p**	8.2p	16
- reported	**5.1p**	5.5p	(7)	**8.8p**	8.3p	6
Interim dividend	**-**	-	-	**2.4p**	2.3p	4
Capital expenditure	**608**	558	9	**1,131**	1,117	1
Free cash flow	**535**	705	(24)	**950**	583	63
Net debt	**-**	-	-	**8,704**	9,878	(12)

Line of business results

	Adjusted revenue[1]			Adjusted EBITDA[1]			Operating cash flow		
Second quarter to 30 September	**2010 £m**	2009[2] £m	Change %	**2010 £m**	2009[3] £m	Change %	**2010 £m**	2009[3] £m	Change %
BT Global Services	**1,991**	2,024	(2)	**138**	95	45	**(28)**	(103)	73
BT Retail	**1,929**	2,019	(4)	**414**	451	(8)	**333**	430	(23)
BT Wholesale	**1,054**	1,109	(5)	**326**	344	(5)	**222**	212	5
Openreach	**1,235**	1,234	-	**532**	507	5	**255**	280	(9)
Other and intra-group items	**(1,232)**	(1,264)	3	**42**	18	133	**(247)**	(114)	(117)
Total	**4,977**	5,122	(3)	**1,452**	1,415	3	**535**	705	(24)

[1] Before specific items. Specific items are defined below and analysed in Note 5
[2] Adjusted for the impact of customer account moves and the impact of changes in the internal trading model. The effect of the changes is primarily to reduce internal revenue in both BT Wholesale and Openreach by around £62m per quarter in 2010/11. There is no impact from these changes on total group revenue. In the line of business commentaries for BT Wholesale and Openreach, revenue has been measured against an adjusted basis taking account of the changes in the internal trading model to enable a like for like comparison
[3] Restated for the impact of customer account moves. See Note 1

Notes: Unless otherwise stated, any reference to earnings before interest, tax, depreciation and amortisation (EBITDA), operating profit, operating costs, profit before tax and earnings per share (EPS) are measured before specific items. The commentary focuses on the trading results before specific items. This is consistent with the way that financial performance is measured by management and is reported to the Board and the Operating Committee and assists in providing a meaningful analysis of the trading results of the group. The directors believe that presentation of the group's results in this way is relevant to the understanding of the group's financial performance as specific items are those that in management's judgement need to be disclosed by virtue of their size, nature or incidence. In determining whether an event or transaction is specific, management considers quantitative as well as qualitative factors such as the frequency or predictability of occurrence. Specific items may not be comparable to similarly titled measures used by other companies.

Reported EBITDA, reported operating profit, reported profit before tax and reported EPS are the equivalent unadjusted or statutory measures. Unless otherwise stated, the change in results is year on year.

The income statement, cash flow statement, statements of comprehensive income and equity and balance sheet are provided on pages 11 to 15. A reconciliation of group operating profit to EBITDA (as defined above) is provided in Note 6. A reconciliation of reported profit before tax (as defined above) to adjusted profit before tax is provided in Note 7. A reconciliation of reported EPS (as defined above) to adjusted EPS is provided in Note 8. A definition and reconciliation of free cash flow and net debt are provided in Notes 9 and 10.

Enquiries

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A presentation for analysts and investors will be held in London at 9.00am today and a simultaneous webcast will be available at www.bt.com/results.

Results for the third quarter to 31 December 2010 are expected to be announced on 3 February 2011.

About BT
BT is one of the world's leading providers of communications solutions and services operating in over 170 countries. Its principal activities include the provision of networked IT services globally; local, national and international telecommunications services to our customers for use at home, at work and on the move; broadband and internet products and services and converged fixed/mobile products and services. BT consists principally of four lines of business: BT Global Services, BT Retail, BT Wholesale and Openreach.

British Telecommunications plc (BT) is a wholly-owned subsidiary of BT Group plc and encompasses virtually all businesses and assets of the BT Group. BT Group plc is listed on stock exchanges in London and New York.

For more information, visit www.btplc.com

BT Group plc
INTERIM MANAGEMENT REPORT

RESULTS FOR THE SECOND QUARTER TO 30 SEPTEMBER 2010

GROUP RESULTS

Operating results overview

Revenue was down 3% to £4,977m. Adjusted EBITDA increased by 3% to £1,452m primarily due to improved efficiency leading to lower costs. Foreign exchange movements had no significant impact on revenue or EBITDA in the quarter.

Total group operating costs reduced by £216m, or 5%, to £4,343m. Depreciation and amortisation decreased by 3% to £737m reflecting lower levels of capital expenditure last year. Excluding depreciation and amortisation, group operating costs reduced by £194m or 5%.

Total labour costs decreased by 4% to £1,454m. Direct labour costs were broadly flat year on year, with reductions in direct labour resource being offset by the impact of pay inflation and higher pension costs. Leaver costs were £14m (Q2 2009/10: £21m). Indirect labour costs reduced by 20% as the group continues to reduce agency and contractor resource and redeploy existing permanent staff. Payments to telecommunications operators were down by 7% reflecting lower mobile termination rates and lower transit and wholesale call volumes. Property and energy costs were 12% lower as the group continues to drive efficiency improvements.

Capital expenditure increased by £50m to £608m in line with the phasing of our major investment programmes.

Net finance expense

Net finance expense was £224m, a decrease of £1m. While our net debt has reduced significantly the interest earned on our cash and short term investments balances of £2.7bn is considerably lower than the average interest cost on our debt. As our debt matures, this position will improve and the average interest rate on net debt will fall.

Tax

The effective tax rate on the profit before specific items was 22% for the half year which reflects our current expectations for the full year. The reduction from our previous full year estimate of 24.5% is due to tax efficiencies that are expected to have a benefit in 2010/11.

Specific items

Specific operating costs comprise property rationalisation charges of £24m (Q2 2009/10: £nil) and BT Global Services restructuring charges of £47m (Q2 2009/10: £49m). Net interest expense on pensions was £19m (Q2 2009/10: £70m). The tax credit in respect of these items was £16m (Q2 2009/10: £41m).

The UK Finance Bill 2010/11, under which the UK corporation tax rate changes from 28% to 27% from 1 April 2011, was enacted in the quarter. As a result, a specific tax credit of £76m has been recognised for the re-measurement of deferred tax balances.

In the prior year we recognised a tax credit of £215m and associated interest of £11m relating to the agreement of substantially all outstanding tax matters with HMRC for the 2006, 2007 and 2008 tax years. In addition, a charge of £52m was recognised against revenue reflecting an Ofcom determination in relation to 2Mbps partial private circuits.

Earnings per share

Adjusted EPS was 5.1p, up 16% due to the higher operating profit. Reported EPS was also 5.1p as the specific items had no net impact on a post tax basis. The reduction of 7% in reported EPS was primarily due to the prior year tax credit.

Free cash flow

Free cash flow was an inflow of £535m, £170m lower than last year because the prior year included the benefit of a tax repayment and associated interest of £226m. Excluding this, free cash flow increased by £56m reflecting improved EBITDA partially offset by higher capital expenditure. There was a net cash outflow of £41m relating to specific items (Q2 2009/10: £161m inflow) principally comprising BT Global Services restructuring costs. Excluding these items, free cash flow before specific items was £576m (Q2 2009/10: £544m).

Net debt and liquidity

Net debt was £8,704m at 30 September 2010 (30 September 2009: £9,878m) a reduction of £1,174m in the year. Dividends paid in the quarter were £353m (Q2 2009/10: £84m).

At 30 September 2010, we had undrawn committed facilities of £2.2bn in addition to cash and investments of £2.7bn which provide us with a strong liquidity and funding position.

Pensions

The IAS 19 net pension position at 30 September 2010 was a deficit of £3.8bn net of tax (£5.2bn gross of tax), compared with a net deficit of £5.7bn at 31 March 2010 (£7.9bn gross of tax). The market value of the BT Pension Scheme assets has decreased by £0.4bn since 31 March 2010 to £34.9bn at 30 September 2010. As announced on 4 November 2010, the value of the liabilities has decreased to £40.0bn primarily due to the £2.9bn impact of the government's decision that Consumer Prices Index (CPI) rather than Retail Prices Index (RPI) will be used as the basis for the indexation of pensions. The liability calculation is based on the AA bond rate of 5.00% (31 March 2010: 5.50%) and future RPI inflation expectations of 3.00% (31 March 2010: 3.60%). CPI has been assumed to be an average of 0.75% per annum lower than RPI in the long term, with a difference of 1.0% for the next five years.

The pension valuation on a 'median estimate' basis at 30 September 2010 was a deficit of £0.2bn compared with £3.0bn at 31 December 2008, when the funding valuation was £9.0bn. This 'median estimate' reflects how investments might on average be expected to perform over time based on best estimate return assumptions published in the Towers Watson Global Asset Model.

Outlook

We now expect adjusted EBITDA to be around £5.8bn for the full year. In addition, we expect to achieve our outlook for free cash flow of £2bn (before cash specific items of around £200m) this financial year.

For 2011/12 and 2012/13 we expect free cash flow (before cash specific items) to be above £2bn. Otherwise our outlook for the period to 2012/13 remains unchanged.

Dividends

The Board has declared an interim dividend of 2.4p per share (Q2 2009/10: 2.3p), an increase of 4%. This will be paid on 7 February 2011, to shareholders on the register on 31 December 2010. The ex-dividend date is 29 December 2010. The election date for participation in BT's Dividend Investment Plan in respect of this dividend is 31 December 2010.

The interim dividend, amounting to £186m (Q2 2009/10: £178m), has not been included as a liability at 30 September 2010. The final dividend for the year to 31 March 2010 of 4.6p per share was approved at the Annual General Meeting on 22 July 2010 and was paid in the second quarter.

OPERATING REVIEW

BT Global Services

	Second quarter to 30 September				Half year to 30 September	
	2010	2009	Change		**2010**	2009
	£m	£m	£m	%	**£m**	£m
Revenue	**1,991**	2,024	(33)	(2)	**3,998**	4,103
Net operating costs[1]	**1,853**	1,929	(76)	(4)	**3,730**	3,946
EBITDA	**138**	95	43	45	**268**	157
Depreciation & amortisation	**179**	191	(12)	(6)	**363**	377
Operating loss	**(41)**	(96)	55	57	**(95)**	(220)
Capital expenditure	**124**	131	(7)	(5)	**227**	262
Operating cash flow	**(28)**	(103)	75	73	**(66)**	(568)

[1] Net of other operating income

Revenue
Revenue decreased by 2% reflecting the ongoing trend of declining UK calls and lines revenue, and the impact of lower wholesale call volumes in Continental Europe.

Total order intake was £2.1bn (Q1 2010/11 £1.6bn; Q2 2009/10: £1.4bn). The increase in the quarter reflects a number of new contracts and extensions, including a three-year extension to the Defence Fixed Telecommunications Service agreement with the UK Ministry of Defence and a two-year extension of a contract with the UK's rail infrastructure operator Network Rail. We signed new contracts with leading organisations in the global financial services sector, including UBS for global voice and data services and Nationwide for call centre developments. We also signed new contracts outside the UK with customers such as HeidelbergCement, Anglo American and the Ministerio de Defensa de España.

In October we signed a Memorandum of Understanding with the UK government covering all of BT's central government contracts, all of which remain in place. The new arrangements will help deliver savings to government through greater efficiencies and economies of scale. We expect to have further discussions with the government about additional efficiencies and opportunities.

During the quarter we made further progress with our investment programme in the Asia Pacific region. As part of this programme we are hiring around 300 new people to ensure that key services enjoyed by BT's customers elsewhere in the world can be offered and fully supported in the region. We are also establishing a new bid response centre in Singapore and expanding our professional services capabilities across the region.

Operating results
We have made further progress with our cost efficiency initiatives during the quarter, including further supplier negotiations, and as a result net operating costs reduced by 4%. Our cost reduction activities helped deliver EBITDA of £138m, an increase of 45%.

Operating cash flow improved by £502m in the half year. This includes a receipt of around £200m in the first quarter relating to a major customer contract. It also reflects the higher EBITDA, working capital improvements and lower capital expenditure.

BT Retail

	Second quarter to 30 September				Half year to 30 September	
	2010	2009[1]	Change		**2010**	2009[1]
	£m	£m	£m	%	**£m**	£m
Revenue	**1,929**	2,019	(90)	(4)	**3,854**	4,087
Net operating costs[2]	**1,515**	1,568	(53)	(3)	**2,998**	3,184
EBITDA	**414**	451	(37)	(8)	**856**	903
Depreciation & amortisation	**111**	119	(8)	(7)	**222**	236
Operating profit	**303**	332	(29)	(9)	**634**	667
Capital expenditure	**99**	82	17	21	**184**	163
Operating cash flow	**333**	430	(97)	(23)	**626**	758

[1] Restated for the impact of customer account moves
[2] Net of other operating income

Revenue
Total revenue decreased by 4%. Business revenue was flat, an improvement over the 4% decline last quarter, reflecting growth in IT services and mobility revenues as well as an improvement in line losses which were 41% lower than last year. Consumer revenue declined by 6%, the same as last quarter, as calls and lines revenue continued to decline reflecting the competitive marketplace.

Enterprises revenue was broadly flat, although BT Conferencing revenue increased by 7%. BT Ireland revenue declined by 6%, the same as last quarter, although excluding foreign exchange movement the decline was 3% reflecting the challenging economic conditions.

It was a good quarter in broadband with net additions of 114,000, representing a 45% market share of DSL and LLU net additions, one of our highest shares ever. We have continued to see growth in WiFi, with our network of WiFi hotspots increasing to over 2m and our customer minutes more than doubling over last year. We have also seen over 170,000 downloads of the free BT Fon application to Apple's iPhone and Google's Android devices since its September launch which automatically connects customers to our WiFi hotspots.

We continue to accelerate the migration of customers to higher speed services and we now have around 1.6m customers on our 20Mbps or BT Infinity broadband services, a six fold increase from last year. Orders for BT Infinity, our fibre-based broadband service, are increasing rapidly, currently running at over 4,000 per week and we now have around 38,000 BT Infinity customers. In September we launched an offer whereby customers taking a broadband and calls bundle have been able to register for an upgrade to BT Infinity for no extra monthly cost when fibre becomes available in their area. We have also launched a nationwide initiative 'Race to Infinity' to gauge local demand for fibre-based broadband. This will help us to identify exchange areas where demand is high and influence our future deployment plans.

We saw an increase of a third in the take up of BT Vision with 24,000 net additions in the quarter and our customer base currently stands at 520,000. Of these, over 50,000 have taken our Sky Sports service which commenced broadcasting in August. We are seeing continued increase in usage of BT Vision with average subscription views per customer up 10% since last quarter. We will be making further enhancements to our TV offering with 3D and faster HD downloads available for Christmas. The BBC iPlayer will also be added to our BT Vision service and will be rolled out to our customer base during the second half of the year. We are partners in the YouView consortium, developing a common interface for Internet Protocol Television (IPTV) in the UK, which is expected to launch in the first half of the next calendar year.

Consumer ARPU increased to £317, up £3 over the previous quarter, principally due to a continuing increase in broadband penetration in our customer base.

Operating results
Net operating costs decreased by 3% with savings being partially offset by the planned incremental investments in subscriber acquisition costs, marketing and product development. Excluding the one-off internal rebate of £15m received last year, the decrease was 4%. The decrease in costs was principally due to reductions in total labour costs of 6% resulting from productivity and efficiency improvements. Further cost savings have been achieved through renegotiating supplier contracts and a continuing improvement in debt management processes.

EBITDA decreased by 8% reflecting the incremental investments, although excluding the one-off £15m rebate, the decrease was 5%. Depreciation and amortisation decreased by 7%. Operating profit decreased by 9% although excluding the one-off rebate, the decrease was 4%.

Capital expenditure increased by 21% to £99m partly reflecting the roll out of fibre-based broadband in Northern Ireland. Operating cash flow for the quarter was down 23% primarily due to reduced EBITDA, higher working capital and increased capital expenditure.

BT Wholesale

	Second quarter to 30 September				Half year to 30 September	
	2010	2009[1]	Change		**2010**	2009[1]
	£m	£m	£m	%	**£m**	£m
Revenue						
- adjusted[2]	**1,054**	1,109	(55)	(5)	**2,113**	2,235
- reported	**1,054**	1,160	(106)	(9)	**2,113**	2,337
Net operating costs[3]	**728**	816	(88)	(11)	**1,448**	1,655
EBITDA	**326**	344	(18)	(5)	**665**	682
Depreciation & amortisation	**155**	170	(15)	(9)	**309**	341
Operating profit	**171**	174	(3)	(2)	**356**	341
Capital expenditure	**79**	69	10	14	**146**	140
Operating cash flow	**222**	212	10	5	**439**	333

[1] Restated for the impact of customer account moves
[2] Prior year revenue adjusted for changes in the internal trading model
[3] Net of other operating income

Revenue

Adjusted revenue for the quarter decreased by 5%. This reflected an £18m reduction in low margin transit revenue primarily due to lower volumes and a £19m one-off regulatory charge due to an Ofcom determination on termination rates for 0845 and 0870 calls, which we are appealing. Excluding these, revenue declined by 2% mainly due to a reduction in broadband revenue partly as a result of continued migration to LLU. Managed network services (MNS) revenue represented 23% of external revenue (Q2 2009/10: 21%) and the proportion of our revenue under long term contracts remains at around 40%.

During the quarter we announced that we have selected Cisco's content delivery system to form the backbone of our new open, online video delivery network designed to improve the economics and customer experience of delivering video over broadband and to support a range of new TV services.

Operating results

Net operating costs, excluding changes in the internal trading model, reduced by 5%. The decrease was due to a reduction in total labour costs from process simplification and systems automation and continued control of discretionary expenditure as well as lower transit volumes. EBITDA declined by £18m or 5%, but excluding the impact of the one-off regulatory charge EBITDA was flat. The regulatory charge did not impact group EBITDA as it was offset by the release of provisions for such charges in the 'Other' segment. Depreciation and amortisation decreased by 9%. Operating profit decreased by 2%, although excluding the one-off regulatory charge, operating profit increased by 9%.

Capital expenditure increased by 14% partly reflecting commitments under MNS contracts signed this year. Operating cash flow increased by 5% primarily due to improvements in working capital.

Openreach

	Second quarter to 30 September				Half year to 30 September	
	2010	2009[1]	Change		**2010**	2009[1]
	£m	£m	£m	%	**£m**	£m
Revenue						
- adjusted[1]	**1,235**	1,234	1	-	**2,435**	2,489
- reported	**1,235**	1,285	(50)	(4)	**2,435**	2,591
Net operating costs[2]	**703**	778	(75)	(10)	**1,392**	1,609
EBITDA	**532**	507	25	5	**1,043**	982
Depreciation & amortisation	**214**	223	(9)	(4)	**429**	424
Operating profit	**318**	284	34	12	**614**	558
Capital expenditure	**262**	200	62	31	**498**	403
Operating cash flow	**255**	280	(25)	(9)	**480**	509

[1] Prior year revenue adjusted for changes in the internal trading model
[2] Net of other operating income

Adjusted revenue was maintained year on year with significantly increased provisioning volumes in both Ethernet and LLU infrastructure for key customers, driven by the increased demand for bandwidth and broadband by end-users, offset by continued migration from WLR to lower priced MPF. We have seen an improvement in line losses, which were 75% lower than last year. The ongoing growth of end-users using external WLR and LLU products contributed to the switch from internal to external revenues, with external revenue increasing by 22% and internal revenue decreasing by 7%, excluding the impact of the change in the trading model.

On 11 October 2010, the Competition Appeals Tribunal (CAT) issued its final judgement on an appeal of Ofcom's LLU and WLR charge control decisions. The CAT largely upheld the original decisions and as a result, only minor price changes are to be made to selected LLU products with effect from 15 October 2010. No price changes are required for the WLR portfolio.

Operating results

Excluding changes in the internal trading model, net operating costs reduced by 3% reflecting cost savings delivered through process efficiencies in volume engineering activities. EBITDA increased by 5% and depreciation and amortisation reduced by 4%, resulting in an increase in operating profit of 12%.

Capital expenditure increased by 31% due to the step up in activity in our fibre roll out programme and we have passed 3m premises. The increase in revenue from Communications Providers (CPs) infrastructure build and provision activities has contributed to increased capital expenditure, which has more than offset unit cost savings achieved through efficiencies and lower input costs from suppliers. Operating cash flow decreased by 9%, as the increased EBITDA was more than offset by the additional capital expenditure.

We have around 25 CPs either engaged in trials or offering super fast broadband services based on our fibre network, giving end-users real choice.

During the quarter, BT and Cornwall Council announced plans to extend our fibre network across Cornwall and the Isles of Scilly with the first end-users being connected by spring 2011. We plan to deliver fibre to up to 90% of the region by mid 2014. Cornwall is one of the areas in the so called 'final third' of the UK, and has been enabled through joint funding with the European Union.

RESULTS FOR THE HALF YEAR TO 30 SEPTEMBER 2010

Operating results overview

Revenue was down 4% to £9,983m. Adjusted EBITDA increased by 4% to £2,851m primarily due to improved efficiency leading to lower costs. Foreign exchange movements had no significant impact on revenue or EBITDA in the half year.

Total group operating costs decreased by £518m, or 6%, to £8,767m. This was primarily due to reductions in total labour resource and the delivery of other cost saving initiatives by all lines of business. Depreciation and amortisation decreased by 2% to £1,466m reflecting lower levels of capital expenditure last year. Excluding depreciation and amortisation, group operating costs reduced by £487m or 6%.

Total labour costs decreased by 6% to £2,926m. Direct labour costs decreased by 1% while third party labour costs reduced by 25% as the group continues to reduce agency and contractor resource and redeploy existing permanent staff. Leaver costs were £24m (HY 2009/10: £66m). Payments to telecommunications operators were down by 8% reflecting lower mobile termination rates and lower transit and wholesale call volumes. Property and energy costs were 11% lower as the group continues to drive efficiency improvements.

Capital expenditure increased by £14m to £1,131m in line with our plans.

Net finance expense

Net finance expense was £452m, an increase of £13m.

Tax

The effective tax rate on the profit before specific items was 22.0% (HY 2009/10: 23.2%).

Specific items

Specific operating costs comprise property rationalisation charges of £54m (HY 2009/10: £nil), BT Global Services restructuring charges of £68m (HY 2009/10: £90m), net interest on pensions of £39m (HY 2009/10: £139m) and a specific tax credit of £76m for the re-measurement of deferred tax balances for the change in the UK statutory corporation tax rate to 27%, effective from 1 April 2011.

In the prior year we recognised a tax credit of £215m and associated interest of £11m relating to the agreement of substantially all outstanding tax matters with HMRC for the 2006, 2007 and 2008 tax years.

Earnings per share

Adjusted EPS was 9.5p, up 16%, principally reflecting the higher operating profit. Reported EPS was 8.8p, up 6%. This is based on average shares in issue of 7,747m (HY 2009/10: 7,737m).

Free cash flow

Free cash flow was an inflow of £950m, an increase of £367m compared with last year. The prior year included the benefit of tax repayments and associated interest of £436m. Excluding this, free cash flow increased by £803m reflecting improved EBITDA and working capital and the receipt of around £200m relating to a major customer contract in the first quarter. There was a net cash outflow of £85m relating to specific items (HY 2009/10: £92m inflow) principally comprising BT Global Services restructuring costs. Excluding these items, free cash flow before specific items was £1,035m (HY 2009/10: £491m).

Related party transactions

Transactions with related parties during the half year to 30 September 2010 are disclosed in Note 13.

Principal risks and uncertainties

A summary of the group's principal risks and uncertainties is provided in Note 14.

FINANCIAL STATEMENTS

Group income statement
For the second quarter to 30 September 2010

	Notes	Before specific items £m	Specific items (Note 5) £m	Total £m
Revenue	2	4,977	-	**4,977**
Other operating income		81	-	**81**
Operating costs	4	(4,343)	(71)	**(4,414)**
Operating profit		715	(71)	**644**
Finance expense		(227)	(581)	**(808)**
Finance income		3	562	**565**
Net finance expense		(224)	(19)	**(243)**
Share of post tax profits of associates and joint ventures		5	-	**5**
Profit before tax		496	(90)	**406**
Tax		(98)	92	**(6)**
Profit for the period		398	2	**400**
Attributable to:				
Equity shareholders		397	2	**399**
Minority interests		1	-	**1**
Earnings per share	8			
- basic		5.1p		**5.1p**
- diluted		4.9p		**4.9p**

Group income statement
For the second quarter to 30 September 2009

	Notes	Before specific items £m	Specific items (Note 5) £m	Total £m
Revenue	2	5,122	(52)	**5,070**
Other operating income		93	-	**93**
Operating costs	4	(4,559)	(54)	**(4,613)**
Operating profit		656	(106)	**550**
Finance expense		(226)	(552)	**(778)**
Finance income		1	493	**494**
Net finance expense		(225)	(59)	**(284)**
Share of post tax profits of associates and joint ventures		9	-	**9**
Profit before tax		440	(165)	**275**
Tax		(103)	256	**153**
Profit for the period		337	91	**428**
Attributable to:				
Equity shareholders		337	91	**428**
Minority interests		-	-	**-**
Earnings per share	8			
- basic		4.4p		**5.5p**
- diluted		4.2p		**5.4p**

Group income statement
For the half year to 30 September 2010

	Notes	Before specific items £m	Specific items (Note 5) £m	Total £m
Revenue	2	9,983	-	**9,983**
Other operating income		169	-	**169**
Operating costs	4	(8,767)	(122)	**(8,889)**
Operating profit		1,385	(122)	**1,263**
Finance expense		(458)	(1,161)	**(1,619)**
Finance income		6	1,122	**1,128**
Net finance expense		(452)	(39)	**(491)**
Share of post tax profits of associates and joint ventures		9	-	**9**
Profit before tax		942	(161)	**781**
Tax		(207)	110	**(97)**
Profit for the period		735	(51)	**684**
Attributable to:				
Equity shareholders		734	(51)	**683**
Minority interests		1	-	**1**
Earnings per share	8			
- basic		9.5p		**8.8p**
- diluted		9.1p		**8.5p**

Group income statement
For the half year to 30 September 2009

	Notes	Before specific items £m	Specific items (Note 5) £m	Total £m
Revenue	2	10,357	(52)	**10,305**
Other operating income		172	-	**172**
Operating costs	4	(9,285)	(95)	**(9,380)**
Operating profit		1,244	(147)	**1,097**
Finance expense		(441)	(1,104)	**(1,545)**
Finance income		2	976	**978**
Net finance expense		(439)	(128)	**(567)**
Share of post tax profits of associates and joint ventures		17	-	**17**
Profit before tax		822	(275)	**547**
Tax		(191)	286	**95**
Profit for the period		631	11	**642**
Attributable to:				
Equity shareholders		631	11	**642**
Minority interests		-	-	**-**
Earnings per share	8			
- basic		8.2p		**8.3p**
- diluted		8.0p		**8.1p**

Group statement of comprehensive income
For the second quarter and half year to 30 September

	Second quarter to 30 September		Half year to 30 September	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Profit for the period	**400**	428	**684**	642
Other comprehensive income (loss)				
Actuarial movements on defined benefit pension schemes	**2,787**	(1,380)	**2,781**	(5,397)
Exchange gains (losses) on translation of foreign operations	**-**	193	**(116)**	(172)
Fair value movements on cash flow hedges				
- fair value (losses) gains	**(157)**	460	**(259)**	(1,053)
- recycled and reported in net profit	**48**	(419)	**317**	635
- reclassified and reported in non current assets	**-**	-	**-**	2
Movement in assets available for sale reserve	**1**	3	**(1)**	5
Tax on components of other comprehensive income	**(796)**	375	**(774)**	1,641
Other comprehensive income (loss) for the period, net of tax	**1,883**	(768)	**1,948**	(4,339)
Total comprehensive income (loss) for the period	**2,283**	(340)	**2,632**	(3,697)
Attributable to:				
Equity shareholders	**2,283**	(341)	**2,632**	(3,698)
Minority interests	**-**	1	**-**	1
	2,283	(340)	**2,632**	(3,697)

Group statement of changes in equity
For the half year to 30 September 2010

	Share capital	**(Deficit) Reserves**	**Minority interests**	**Total equity**
	£m	**£m**	**£m**	**£m**
At 1 April 2010	**408**	**(3,058)**	**24**	**(2,626)**
Total comprehensive income for the period	**-**	**2,632**	**-**	**2,632**
Share-based payment	**-**	**33**	**-**	**33**
Net movement on treasury shares	**-**	**2**	**-**	**2**
Tax on items taken directly to equity	**-**	**(2)**	**-**	**(2)**
Dividends on ordinary shares	**-**	**(357)**	**-**	**(357)**
At 30 September 2010	**408**	**(750)**	**24**	**(318)**

For the half year to 30 September 2009

	Share capital	**(Deficit) Reserves**	**Minority interests**	**Total equity**
	£m	**£m**	**£m**	**£m**
At 1 April 2009	408	(266)	27	169
Total comprehensive loss for the period	-	(3,698)	1	(3,697)
Share-based payment	-	38	-	38
Net movement on treasury shares	-	1	-	1
Dividends on ordinary shares	-	(85)	-	(85)
Disposals	-	-	(4)	(4)
At 30 September 2009	408	(4,010)	24	(3,578)

Group cash flow statement
For the second quarter and half year to 30 September

	Second quarter to 30 September		Half year to 30 September	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Profit before tax	**406**	275	**781**	547
Depreciation and amortisation	**737**	759	**1,466**	1,497
Net finance expense	**243**	284	**491**	567
Associates and joint ventures	**(5)**	(9)	**(9)**	(17)
Share based payments	**15**	18	**33**	36
Increase in working capital	**(110)**	(100)	**(260)**	(699)
Provisions, pensions and other non cash movements	**23**	(16)	**146**	(91)
Cash generated from operations	**1,309**	1,211	**2,648**	1,840
Tax (paid) received	**(10)**	201	**(15)**	411
Net cash inflow from operating activities	**1,299**	1,412	**2,633**	2,251
Cash flow from investing activities				
Interest received	**3**	12	**5**	13
Dividends received from associates and joint ventures	**1**	-	**4**	1
Proceeds on disposal of property, plant and equipment	**5**	11	**9**	18
Acquisition of subsidiaries, net of cash acquired	**(2)**	(1)	**(2)**	(13)
Purchases of property, plant and equipment and computer software	**(607)**	(566)	**(1,221)**	(1,251)
Purchases of non current financial assets	**-**	-	**(17)**	-
Purchases of current financial assets	**(1,800)**	(2,019)	**(4,923)**	(4,663)
Sale of current financial assets	**1,583**	2,102	**2,886**	3,902
Net cash used in investing activities	**(817)**	(461)	**(3,259)**	(1,993)
Cash flow from financing activities				
Interest paid	**(166)**	(164)	**(463)**	(449)
Equity dividends paid	**(353)**	(84)	**(354)**	(86)
Repayments of borrowings	**-**	(279)	**(6)**	(290)
Repayment of finance lease liabilities	**-**	-	**(4)**	-
Receipt of bank loans and bonds	**-**	-	**-**	522
Cash flows from derivatives related to net debt	**47**	-	**258**	-
Net proceeds (repayment) on commercial paper	**16**	(521)	**16**	(691)
Proceeds on issue of treasury shares	**1**	-	**2**	1
Net cash used in financing activities	**(455)**	(1,048)	**(551)**	(993)
Effects of exchange rate changes	**-**	18	**(4)**	(12)
Net increase (decrease) in cash and cash equivalents	**27**	(79)	**(1,181)**	(747)
Cash and cash equivalents, net of bank overdrafts, at beginning of period	**236**	447	**1,444**	1,115
Cash and cash equivalents, net of bank overdrafts, at end of period	**263**	368	**263**	368
Free cash flow (Note 9)	**535**	705	**950**	583

Group balance sheet

	30 September 2010 £m	30 September 2009 £m	31 March 2010 £m
Non current assets			
Intangible assets	**3,536**	3,648	3,672
Property, plant and equipment	**14,554**	14,980	14,856
Derivative financial instruments	**1,290**	1,588	1,076
Investments	**76**	58	64
Associates and joint ventures	**193**	143	195
Trade and other receivables	**288**	380	336
Deferred tax assets	**1,394**	2,633	2,196
	21,331	23,430	22,395
Current assets			
Inventories	**127**	115	107
Trade and other receivables	**3,817**	4,166	3,696
Derivative financial instruments	**418**	116	624
Investments	**2,422**	921	406
Cash and cash equivalents	**274**	385	1,452
	7,058	5,703	6,285
Current liabilities			
Loans and other borrowings	**3,432**	415	3,269
Derivative financial instruments	**81**	61	166
Trade and other payables	**6,262**	6,447	6,531
Current tax liabilities	**473**	312	320
Provisions	**124**	230	134
	10,372	7,465	10,420
Total assets less current liabilities	**18,017**	21,668	18,260
Non current liabilities			
Loans and other borrowings	**9,374**	12,278	9,522
Derivative financial instruments	**720**	669	533
Retirement benefit obligations	**5,187**	9,439	7,864
Other payables	**830**	815	804
Deferred tax liabilities	**1,454**	1,619	1,456
Provisions	**770**	426	707
	18,335	25,246	20,886
Capital and reserves			
Called up share capital	**408**	408	408
(Deficit) reserves	**(750)**	(4,010)	(3,058)
Total equity shareholders' deficit	**(342)**	(3,602)	(2,650)
Minority interests	**24**	24	24
Total deficit	**(318)**	(3,578)	(2,626)
	18,017	21,668	18,260

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1 Basis of preparation and accounting policies

These condensed consolidated financial statements ('the financial statements') comprise the financial results of BT Group plc for the quarters and half years to 30 September 2010 and 2009 together with the audited balance sheet at 31 March 2010. The financial statements for the half year to 30 September 2010 have been reviewed by the auditors and their review opinion is on page 23. The financial statements have been prepared in accordance with the Disclosure and Transparency Rules (DTR) of the Financial Services Authority and with IAS 34 *Interim Financial Reporting* as adopted by the European Union. The financial statements should be read in conjunction with the annual financial statements for the year to 31 March 2010.

Except as described below, the financial statements have been prepared in accordance with the accounting policies as set out in the financial statements for the year to 31 March 2010 and have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value. These financial statements do not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006. Statutory accounts for the year to 31 March 2010 were approved by the Board of Directors on 12 May 2010, published on 26 May 2010 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified and did not contain any statement under Section 498 of the Companies Act 2006.

The financial statements for the year to 31 March 2010 refer to new standards and interpretations which have been adopted with effect from 1 April 2010. None of these standards or interpretations has had a significant impact on these financial statements.

Customer account moves
We have restated our 2009/10 line of business comparatives as a result of customer account moves between BT Retail and BT Wholesale effective from 1 April 2010, which have no impact on total group results. The impact on prior period line of business results for the quarters and year to 31 March 2010 was disclosed in Note 2 to the financial statements for the first quarter to 30 June 2010.

Pension interest
Effective from 1 April 2010, we are including net interest on pensions within specific items because of its volatile nature. Comparative figures have been restated accordingly.

Presentation of leaver costs
As stated in our 2009/10 final results announcement, effective from 1 April 2010 group and line of business adjusted results are reported after leaver costs. The impact on prior period group and line of business adjusted EBITDA for the quarters and year to 31 March 2010 was disclosed in Note 2 to the financial statements for the first quarter to 30 June 2010.

Pensions - change in basis of indexation
In July 2010 the UK Government announced its decision that the Consumer Prices Index (CPI), rather than Retail Prices Index (RPI), will be used as the basis for determining the rate of inflation for the statutory revaluation and indexation of occupational pension rights. In determining the most appropriate manner by which to reflect the impact of the change on the liabilities of the BT Pension Scheme (BTPS), the directors have had regard to the draft abstract "Accounting implications of the replacement of the Retail Prices Index with the Consumer Prices Index for retirement benefits" issued by the Urgent Issues Task Force of the UK Accounting Standards Board. The draft abstract states that, where the obligation is to pay pensions with increases based on a general measure of inflation rather than a measure linked specifically to RPI, a change in the inflation assumption represents an actuarial gain or loss rather than a cost relating to past service of employees. Accordingly, the gain on re-measurement of the liabilities of the BTPS to reflect CPI as the inflation measure has been recorded as an actuarial gain in the statement of comprehensive income.

2 Operating results – by line of business

	External revenue[1] £m	Internal revenue £m	Group revenue £m	EBITDA[1] £m	Group operating profit (loss)[1] £m
Second quarter to 30 September 2010					
BT Global Services	**1,991**	-	**1,991**	**138**	**(41)**
BT Retail	**1,800**	**129**	**1,929**	**414**	**303**
BT Wholesale	**808**	**246**	**1,054**	**326**	**171**
Openreach	**372**	**863**	**1,235**	**532**	**318**
Other and intra-group items[2]	**6**	**(1,238)**	**(1,232)**	**42**	**(36)**
Total	**4,977**	**-**	**4,977**	**1,452**	**715**
Second quarter to 30 September 2009[3]					
BT Global Services	2,024	-	2,024	95	(96)
BT Retail	1,929	90	2,019	451	332
BT Wholesale	853	307	1,160	344	174
Openreach	306	979	1,285	507	284
Other and intra-group items[2]	10	(1,376)	(1,366)	18	(38)
Total	5,122	-	5,122	1,415	656
Half year to 30 September 2010					
BT Global Services	**3,998**	**-**	**3,998**	**268**	**(95)**
BT Retail	**3,640**	**214**	**3,854**	**856**	**634**
BT Wholesale	**1,625**	**488**	**2,113**	**665**	**356**
Openreach	**703**	**1,732**	**2,435**	**1,043**	**614**
Other and intra-group items[2]	**17**	**(2,434)**	**(2,417)**	**19**	**(124)**
Total	**9,983**	**-**	**9,983**	**2,851**	**1,385**
Half year to 30 September 2009[3]					
BT Global Services	4,103	-	4,103	157	(220)
BT Retail	3,914	173	4,087	903	667
BT Wholesale	1,724	613	2,337	682	341
Openreach	594	1,997	2,591	982	558
Other and intra-group items[2]	22	(2,783)	(2,761)	17	(102)
Total	10,357	-	10,357	2,741	1,244

[1] Before specific items
[2] Elimination of intra-group revenue, which is included in the total revenue of the originating business
[3] Restated – see Note 1 for details

3 Capital expenditure – by line of business

	Second quarter to 30 September		Half year to 30 September	
	2010 £m	2009 £m	**2010 £m**	2009 £m
BT Global Services	**124**	131	**227**	262
BT Retail	**99**	82	**184**	163
BT Wholesale	**79**	69	**146**	140
Openreach	**262**	200	**498**	403
Other	**44**	76	**76**	149
Total	**608**	558	**1,131**	1,117

4 Operating costs

	Second quarter to 30 September		Half year to 30 September	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Direct labour costs	**1,201**	1,206	**2,444**	2,472
Indirect labour costs	**253**	315	**482**	640
Total labour costs	**1,454**	1,521	**2,926**	3,112
Direct labour capitalised	**(189)**	(133)	**(341)**	(277)
Indirect labour capitalised	**(83)**	(117)	**(162)**	(235)
Net labour costs	**1,182**	1,271	**2,423**	2,600
Leaver costs	**14**	21	**24**	66
Payments to telecommunications operators	**970**	1,040	**1,931**	2,088
Property and energy costs	**278**	317	**565**	637
Network maintenance and IT costs	**185**	190	**363**	399
General and administrative costs	**311**	322	**656**	665
Other operating costs	**666**	639	**1,339**	1,333
Operating costs before depreciation and specific items	**3,606**	3,800	**7,301**	7,788
Depreciation and amortisation	**737**	759	**1,466**	1,497
Total operating costs before specific items	**4,343**	4,559	**8,767**	9,285
Specific items (Note 5)	**71**	54	**122**	95
Total operating costs	**4,414**	4,613	**8,889**	9,380

5 Specific items

The group separately identifies and discloses those items that in management's judgement need to be disclosed by virtue of their size, nature or incidence (termed 'specific items'). This is consistent with the way that financial performance is measured by management and assists in providing a meaningful analysis of the trading results of the group. In determining whether an event or transaction is specific, management considers quantitative as well as qualitative factors such as the frequency or predictability of occurrence. Specific items may not be comparable to similarly titled measures used by other companies.

	Second quarter to 30 September		Half year to 30 September	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Revenue provision for regulatory settlement	**-**	52	**-**	52
BT Global Services restructuring charges	**47**	49	**68**	90
Property rationalisation charges	**24**	-	**54**	-
Costs associated with settlement of prior tax years	**-**	5	**-**	5
Specific operating costs	**71**	54	**122**	95
Net interest expense on pensions	**19**	70	**39**	139
Interest income on settlement of prior tax years	**-**	(11)	**-**	(11)
Specific net finance expense	**19**	59	**39**	128
Net specific items charge before tax	**90**	165	**161**	275
Tax credit on specific items before tax	**(16)**	(41)	**(34)**	(71)
Tax credit on re-measurement of deferred tax	**(76)**	-	**(76)**	-
Tax credit in respect of settlement of prior tax years	**-**	(215)	**-**	(215)
Net specific items (credit) charge after tax	**(2)**	(91)	**51**	(11)

6 Reconciliation of earnings before interest, taxation, depreciation and amortisation (EBITDA)

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

	Second quarter to 30 September		**Half year to 30 September**	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Reported profit before tax	**406**	275	**781**	547
Share of post tax profits of associates and joint ventures	**(5)**	(9)	**(9)**	(17)
Net finance expense	**243**	284	**491**	567
Operating profit	**644**	550	**1,263**	1,097
Depreciation and amortisation	**737**	759	**1,466**	1,497
Reported EBITDA	**1,381**	1,309	**2,729**	2,594
Specific items (Note 5)	**71**	106	**122**	147
Adjusted EBITDA	**1,452**	1,415	**2,851**	2,741

7 Reconciliation of adjusted profit before tax

	Second quarter to 30 September		**Half year to 30 September**	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Reported profit before tax	**406**	275	**781**	547
Specific items (Note 5)	**90**	165	**161**	275
Adjusted profit before tax	**496**	440	**942**	822

8 Reconciliation of adjusted earnings per share

	Second quarter to 30 September		**Half year to 30 September**	
	2010	2009	**2010**	2009
	pence per share		pence per share	
Reported basic earnings per share	**5.1**	5.5	**8.8**	8.3
Per share impact of specific items	**-**	(1.1)	**0.7**	(0.1)
Adjusted earnings per share	**5.1**	4.4	**9.5**	8.2

9 Free cash flow

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

	Second quarter to 30 September		Half year to 30 September	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Cash generated from operations	**1,309**	1,211	**2,648**	1,840
Tax (paid) received	**(10)**	201	**(15)**	411
Net cash inflow from operating activities	**1,299**	1,412	**2,633**	2,251
Included in cash flows from investing activities				
Net purchase of property, plant, equipment and software	**(602)**	(555)	**(1,212)**	(1,233)
Dividends received from associates	**1**	-	**4**	1
Interest received	**3**	12	**5**	13
Purchases of non current financial assets	**-**	-	**(17)**	-
Included in cash flows from financing activities				
Interest paid	**(166)**	(164)	**(463)**	(449)
Free cash flow	**535**	705	**950**	583

10 Net debt

Net debt at 30 September 2010 was £8,704m (31 March 2010: £9,283m; 30 September 2009: £9,878m). Net debt consists of loans and other borrowings less current asset investments and cash and cash equivalents. Loans and other borrowings are measured at the net proceeds raised, adjusted to amortise any discount over the term of the debt. For the purpose of this analysis, current asset investments and cash and cash equivalents are measured at the lower of cost and net realisable value. Currency denominated balances within net debt are translated to Sterling at swapped rates where hedged. This definition of net debt measures balances at the expected value of future undiscounted cash flows due to arise on maturity of financial instruments and removes the balance sheet adjustments made from the re-measurement of hedged risks under fair value hedges and accrued interest applied to reflect the use of the effective interest method as required by IAS 39. Net debt is not a measure defined under IFRS but is a key indicator used by management in order to assess operational performance.

During the half year to 30 September 2010, the group issued £16m of commercial paper. During the half year to 30 September 2009, the group issued debt of £522m consisting mainly of a £520m long term listed bond maturing in 2014. Debt maturities amounted to £981m consisting of long term debt of £290m and net commercial paper maturities of £691m.

Analysis of net debt

	At 30 September	
	2010	2009
	£m	£m
Loans and other borrowings[1]	**12,806**	12,693
Cash and cash equivalents	**(274)**	(385)
Investments	**(2,422)**	(921)
	10,110	11,387
Adjustments:		
To re-translate currency denominated balances at swapped rates where hedged	**(1,027)**	(1,169)
To remove fair value adjustments and accrued interest applied to reflect the effective interest method	**(379)**	(340)
Net debt	**8,704**	9,878

[1] Includes overdrafts of £11m at 30 September 2010 (30 September 2009: £17m)

After allocating the element of the above adjustments which impacts loans and other borrowings, gross debt at 30 September 2010 was £11,398m (31 March 2010: £11,139m; 30 September 2009: £11,184m). The adjustment to re-translate currency denominated balances at swapped rates where hedged reflects the foreign exchange impact of currency swaps which offset the foreign exchange movement on revaluing currency loans and borrowings.

11 Share capital

In the half year to 30 September 2010 6m shares (HY 2009/10: 2m) were issued from treasury to satisfy obligations under employee share schemes and executive awards at a cost of £19m (HY 2009/10: £7m).

12 Capital commitments

Capital expenditure for property, plant equipment and software contracted for at the balance sheet date but not yet incurred was £565m (31 March 2010: £383m; 30 September 2009: £386m).

13 Related party transactions

During the half year to 30 September 2010, the group purchased services in the normal course of business and on an arm's length basis from its associate, Tech Mahindra Limited. The value of services purchased was £157m (HY 2009/10: £156m) and the amounts outstanding and payable for services at 30 September 2010 was £52m (30 September 2009: £66m).

14 Principal risks and uncertainties

We have processes for identifying, evaluating and managing our risks. Details of our principal risks and uncertainties can be found on pages 36 to 37 of the 2010 Annual Report & Form 20-F and are summarised below. All of them have the potential to impact our business, revenue, profits, assets, liquidity and capital resources adversely.

- The risks arising from operating in highly competitive markets where customers can switch suppliers based on price and service levels as well as competitor activity
- The risks associated with the economic uncertainty in the UK and global economies
- The risks associated with some of our activities being subject to significant price and other regulatory controls
- The risks associated with complex, high value, long term customer contracts
- The risk that there could be a significant failure or interruption of data transfer as a result of factors outside our control
- The risks associated with funding a defined benefit pension scheme.

There have been no significant changes to the principal risks and uncertainties in the half year to 30 September 2010, some or all of which have the potential to impact our results or financial position during the remaining six months of the financial year.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

10 November 2010

Independent review report to BT Group plc on the half year interim financial information

Introduction

We have been engaged by the company to review the condensed set of financial statements in the half year financial report for the six months ended 30 September 2010, which comprises the Group income statement, the Group statement of comprehensive income, the Group statement of changes in equity, the Group cash flow statement, the Group balance sheet and related notes. We have read the other information contained in the half year financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

Directors' responsibilities

The half year financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half year financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in Note 1, the annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half year financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half year financial report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of the Disclosure and Transparency Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half year financial report for the six months ended 30 September 2010 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

PricewaterhouseCoopers LLP
Chartered Accountants
London
10 November 2010

Notes:
The maintenance and integrity of the group's website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Forward-looking statements – caution advised

Certain statements in this results release are forward-looking and are made in reliance on the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995. These statements include, without limitation, those concerning: full year and future outlook; EBITDA; free cash flow; return to revenue growth; net debt, interest, liquidity and funding; effective tax rates; pension liabilities and indexation; BT Global Services' progress, and investment in Asia Pacific; take up of, and enhancements in, our TV offering; investment in, demand for and roll out of fibre.

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

Factors that could cause differences between actual results and those implied by the forward-looking statements include, but are not limited to: material adverse changes in economic conditions in the markets served by BT; future regulatory actions and conditions in BT's operating areas, including competition from others; selection by BT and its lines of business of the appropriate trading and marketing models for its products and services; fluctuations in foreign currency exchange rates and interest rates; technological innovations, including the cost of developing new products, networks and solutions and the need to increase expenditures for improving the quality of service; prolonged adverse weather conditions resulting in a material increase in overtime, staff or other costs; developments in the convergence of technologies; the anticipated benefits and advantages of new technologies, products and services not being realised; the underlying assumptions and estimates made in respect of major customer contracts proving unreliable; the aims of the BT Global Services restructuring programme not being achieved; the outcome of the Pension Regulator's review; and general financial market conditions affecting BT's performance and ability to raise finance. BT undertakes no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.