

Financial results

BT Group plc



Results for the half year to 30 September 2018

1 November 2018

BT Group plc (BT.L) today announced its results for the second quarter and half year to 30 September 2018.

Key strategic developments:

- Philip Jansen announced as new Chief Executive from 1 February 2019 – see separate press release on 25 October
- Nine quarters of successive improvement in customer experience metrics; Group NPS¹ up 3.6 points and Right First Time² up 2.7%
- Majority of major and a number of smaller communications provider customers signed up to Openreach's volume related discounts
- 5G capability demonstrated by EE from a live site in Canary Wharf
- Initiatives to transform our operating model on track; restructuring programme removed c.2,000 roles in the first half

Operational:

- Nearly 2m total ultrafast premises passed; Openreach currently building FTTP to c.13,000 premises per week
- Consumer fixed ARPU up 1% to £38.3, with increased mix of SIM only reducing postpaid mobile ARPU by 0.5% to £22.0
- Mobile churn remains low at 1.2%; fixed churn increased to 1.6% reflecting the impact of recent price increases

Financial:

- Reported revenue of £11,588m down 2% and adjusted³ revenue of £11,624m down 1%⁴ as growth in our consumer business was offset by regulated price reductions in Openreach and declines in our enterprise businesses
- Reported profit before tax of £1,340m and adjusted³ EBITDA of £3,675m, up 2%⁴, mainly driven by higher volume and mix of high-end smartphones in our consumer business and restructuring related cost savings
- Net cash inflow from operating activities of £754m down £1,831m mainly due to £2bn contribution to BTPS. Normalised free cash flow³ of £974m down 22% due to increased cash capital expenditure and timing of working capital movements
- Reported capital expenditure up £140m at £1,833m due primarily to the increase in BDUK grant funding deferral following take up of Openreach's volume related discounts
- Interim dividend of 4.62 pence per share; 30% of last year's full-year dividend of 15.4 pence per share
- Overall outlook maintained. Based on current trading, we expect EBITDA to be in the upper half of our £7.3-£7.4bn range

Gavin Patterson, Chief Executive, commenting on the results, said

"We continued to generate positive momentum in the second quarter resulting in encouraging results for the half year. We are successfully delivering against the core pillars of our strategy with improved customer experience metrics, accelerating ultrafast deployment and positive progress towards transforming our operating model.

"In Consumer, we continue to see strong sales of our converged product, BT Plus, and have seen good mobile sales following new handset launches. Last month EE demonstrated 5G capability from a live site in Canary Wharf. We have maintained momentum in our enterprise businesses despite legacy product declines.

"On 1 October we completed the transfer of 31,000 employees into Openreach, a key part of fulfilling our DCR commitments. Openreach has signed up the majority of its major and a number of its smaller communications providers to its new volume related discounts which should increase average broadband speeds across the UK. We are making positive progress on the key enablers to ensure that we can secure a fair return on our FTTP investment, and are ready to expand the FTTP programme up to and beyond 10 million premises if the conditions are right.

"Our strategy is delivering, with benefits evident from the steps we've been taking to simplify and strengthen the business and improve efficiency. Despite increasingly competitive fixed, mobile and networking markets and continued declines in legacy products there is no change in our overall outlook for the full year. Based on current trading, we expect EBITDA to be in the upper half of our £7.3 - £7.4 billion range."

| Half year to 30 September 2018 | 2018 (IFRS 15) £m | 2017 (IFRS 15 pro forma) £m | 2017 (IAS 18) £m | Change % |
|--|-------------------------|-----------------------------------|------------------------|--------------------|
| Reported measures | | | | |
| Revenue | 11,588 | | 11,786 | (2) |
| Profit before tax | 1,340 | | 1,084 | 24 |
| Profit after tax | 1,052 | | 809 | 30 |
| Basic earnings per share | 10.6p | | 8.2p | 29 |
| Net cash inflow from operating activities | 754 | | 2,585 | (71) |
| Interim dividend | 4.62p | | 4.85p | (5) |
| Capital Expenditure | 1,833 | | 1,693 | 8 |
| Adjusted measures | | | | |
| Adjusted ³ Revenue | 11,624 | 11,770 | 11,800 | (1) ⁴ |
| Change in underlying ³ revenue | | | | (0.9) ⁴ |
| Adjusted ³ EBITDA | 3,675 | 3,605 | 3,596 | 2 ⁴ |
| Adjusted ³ basic earnings per share | 13.3p | 12.8p | 12.7p | 4 ⁴ |
| Normalised free cash flow ³ | 974 | 1,245 | 1,245 | (22) |
| Net debt ³ | 11,895 | 9,520 | 9,520 | £2,375m |

¹ Group NPS measures Net Promoter Score in our retail business and Net Satisfaction in our wholesale business

² Measured against Group-wide 'Right First Time' (RFT) index

³ See Glossary on page 2

⁴ Measured against IFRS 15 pro forma comparative period in the prior year

Customer facing unit results for the half year to 30 September 2018

| Half year to 30 September | Adjusted ¹ revenue | | | Adjusted ¹ EBITDA | | | Normalised free cash flow ¹ | | |
|------------------------------|-------------------------------|------------------------------|------------|------------------------------|------------------------------|----------|--|------------------------------|-------------|
| | 2018 | 2017 | Change | 2018 | 2017 | Change | 2018 | 2017 | Change |
| | £m | (IFRS 15 pro forma) £m | % | £m | (IFRS 15 pro forma) £m | % | £m | (IFRS 15 pro forma) £m | % |
| Consumer | 5,272 | 5,127 | 3 | 1,221 | 1,131 | 8 | 677 | 663 | 2 |
| Business and Public Sector | 2,195 | 2,275 | (4) | 708 | 696 | 2 | 514 | 479 | 7 |
| Wholesale and Ventures | 929 | 1,007 | (8) | 325 | 364 | (11) | 160 | 212 | (25) |
| Global Services | 2,332 | 2,511 | (7) | 208 | 154 | 35 | (44) | (133) | 67 |
| Openreach | 2,472 | 2,509 | (1) | 1,177 | 1,250 | (6) | 259 | 501 | (48) |
| Other | 2 | 6 | n/m | 36 | 10 | n/m | (592) | (477) | (24) |
| Intra-group items | (1,578) | (1,665) | 5 | - | - | - | - | - | - |
| Total | 11,624 | 11,770 | (1) | 3,675 | 3,605 | 2 | 974 | 1,245 | (22) |

¹ See Glossary below
n/m = not meaningful

Glossary of alternative performance measures

| | |
|----------------------------------|--|
| Adjusted | Before specific items |
| EBITDA | Earnings before interest, tax, depreciation and amortisation |
| Adjusted EBITDA | EBITDA before specific items, share of post tax profits/losses of associates and joint ventures and net non-interest related finance expense |
| Free cash flow | Net cash inflow from operating activities after capital expenditure |
| Capital expenditure | Additions to property, plant and equipment and software in the period less proceeds from disposals |
| Normalised free cash flow | Free cash flow after net interest paid, before pension deficit payments (including the cash tax benefit of pension deficit payments) and specific items |
| Net debt | Loans and other borrowings (both current and non-current), less current asset investments and cash and cash equivalents. Currency denominated balances within net debt are translated to Sterling at swapped rates where hedged. Fair value adjustments and accrued interest applied to reflect the effective interest method are removed. |
| Specific items | Items that in management's judgement need to be disclosed separately by virtue of their size, nature or incidence. Further information is provided in note 6 on page 25 |
| Underlying | Excludes specific items, foreign exchange movements and the effect of acquisitions and disposals. Further information is provided in note 1 on page 32 |

We assess the performance of the group using a variety of alternative performance measures. The rationale for using adjusted measures is explained in note 1 on page 32. Results on an adjusted basis are presented before specific items. Reconciliations from the most directly comparable IFRS measures are in Additional Information on pages 32 to 34.

Enquiries

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We will hold the second quarter and half year 2018/19 results call for analysts and investors in London at 9am today and a simultaneous webcast will be available at www.bt.com/results

We are scheduled to announce our third quarter results for 2018/19 on 31 January 2019.

Overview of the second quarter to 30 September 2018

STRATEGIC AND OPERATIONAL UPDATE

Deliver differentiated customer experiences

Investing in the quality of our service, the performance of our network and creating differentiated customer experiences through converged products is central to our strategy. Our customers' overall perception of BT improved for the ninth successive quarter with Group NPS¹ increasing by 3.6 points when compared to the prior year baseline. We are also working on the consistency and quality of our service with our 'Right First Time'² performance increasing by 2.7% from the same baseline period. This has been recognised externally where we picked up a total of six gold awards across our consumer and enterprise businesses at the recent UK Customer Experience Awards.

Service

Openreach delivered a record service performance for voice and broadband products in Q2. We were able to offer a provision first appointment date within 12 days to over 99% of customers, a significant improvement from 85% in Q2 2017/18, whilst missed appointments, where Openreach was at fault, was at an all-time low of 1.7% over the quarter. We remain ahead on all 42 copper and fibre Minimum Service Level (MSL) measures set by Ofcom.

Our proactive maintenance programme has continued to reduce the number of faults in the UK copper network, delivering a 1.3% reduction compared to Q2 last year.

Meeting our initial Ethernet delivery promise for communications provider customers continued to improve, achieving a best ever quarterly performance, 14% better than Q2 2017/18. We have reduced the average time to provide service from 43 working days to 34 in the same period.

We continue to drive significant growth in digital engagement with 2.8m cumulative My BT downloads, My EE registrations up 14% year on year and around 10% of the Plusnet mobile base installing their app within 2 weeks of launch, as we work towards delivering industry leading digital capabilities. We now have over 3m customers using our Call Protect product preventing over 170m unwanted calls since launch.

EE has partnered with Enjoy to offer same day hand-delivery and expert set up and activation of smartphones within Greater London, at no extra cost to customers.

Innovation remains a key element of our strategy and we've continued to improve our BT Sport proposition, including holding our first pay per view event in the quarter, and EE customers can now use the BT Sport App on their TV via casting.

Products

BT Plus, our first Consumer converged offering, continues to see good sales momentum and now has around half a million subscribers, many of whom are taking a mobile product.

During the quarter Global Services announced the launch of a new Service and Network Automation Platform designed to help customers transform their networks using the latest Software Defined Networking and Network Function Virtualisation technologies. Global Services also opened a new Cyber Security Operations Centre in India, monitoring threats against BT's own assets and its customers' networks by proactively identifying and addressing the growing threat of cybercrime.

Invest in integrated network leadership

Mobile

EE demonstrated 5G capability from a live site in Canary Wharf. EE's network gained external recognition by winning RootMetrics awards in all six performance categories, including the UK's best mobile network in nationwide testing for the fifth year in a row.

EE announced that it will be converting mobile spectrum from 3G to 4G, to enable faster mobile data speeds, and a more reliable connection, supporting the latest smartphone launches. The maximum capacity 4G sites in the UK's busiest hotspots lay the foundation for 5G network switch on in 2019.

¹ Group NPS measures Net Promoter Score in our retail business and Net Satisfaction in our wholesale business

² Measured against Group-wide 'Right First Time' (RFT) index

Broadband

Openreach continues to accelerate its FTTP network deployment and is currently building to c.13,000 premises per week. The Wirral and Coventry were announced as the 10th and 11th areas to benefit from its 'Fibre First' programme, which is committed to making FTTP technology available to three million homes and businesses by the end of 2020/21. While it is early in the programme, current deployment costs are continuing to come in at the lower end of expectations.

Openreach continues to extend the reach of fibre broadband which is now available to 27.2m premises. Openreach have now passed nearly 1.3m premises with its Gfast network and more than 680,000 with its FTTP network meaning nearly 2m premises are able to connect to an ultrafast service. Openreach completed around 600,000 fibre broadband net connections in the quarter and more than one million for the half year, and now have more than 10.5m customers connected to fibre (Q2 2017/18: 8.4m).

Openreach announced a reduction in the price it charges for FTTP for small-scale developments of less than 30 properties, by more than three quarters, enabling them to upgrade broadband connectivity.

TV and BT Sport

We've agreed a long term extension to our content supply agreement with Sky. Audience figures continue to grow across TV and digital platforms. The UEFA Champions League group stages saw a 46% increase in viewing figures compared to the same matches last season. Our current Premier League average audience is up 9% year on year with a new record for digital platform only viewing.

Transform our operating model

Our cost transformation programme is on track. Our restructuring programme has removed c.2,000 roles in the period, with the largest element being from Global Services. Overall savings from the programme are currently an annualised benefit of over £350m with an associated cost of £206m.

Following our commitment to Ofcom in 2017, BT Group completed the transfer of 31,000 employees to Openreach Limited on 1 October 2018. This marks the final step in the creation of a more independent, legally separate business. At the same time, BT Northern Ireland Networks was renamed Openreach Northern Ireland and will be reported as part of Openreach (previously Business and Public Sector (Enterprise)).

In September, Global Services held a business briefing which set out a clear path to transform the business. This includes repositioning around its core markets and multi-national customers; building value in strategically selected areas of growth where Global Services can add real value and differentiate on service, including cloud and network infrastructure, cloud collaboration and cyber security; and, moving to lower costs, reduce risk and improve returns. As a result of these actions, Global Services will deliver differentiated service and, over the medium term, reduce operating costs and capital employed resulting in improved EBITDA and free cash flow, and thereby deliver a double digit return on capital employed in two years.

In October, Global Services agreed the sale of part of its operation in Germany, BT Stemmer, to Bechtle. Completion of the transaction is subject to receipt of certain regulatory clearances which are expected during the third quarter.

Regulation

Broadband universal service obligation (USO)

In September, BT was one of five parties who responded to Ofcom's Expression of Interest stating, subject to various dependencies, our willingness to be designated a Universal Service Provider (USP). Ofcom issued a further consultation on 13 September on the process they will follow, and proposes a direct designation approach. We expect Ofcom to identify who the USPs will be towards the end of the year, and at the same time consult on the specific USO conditions.

Early Termination Charges investigation

In May, Ofcom opened an enforcement investigation into EE's early termination charges (ETCs) for its mobile customers, both as regards their transparency and calculation. We are cooperating with Ofcom's investigation.

Consumer engagement

In September, the Competition and Markets Authority (CMA) received a super-complaint from Citizens Advice about long term customers overpaying for key services, and inviting them to conduct a market study. A number of markets are identified including retail mobile and fixed broadband. The CMA has 90 days to decide next steps. We have submitted our initial observations.

Other matters

Brexit

There continues to be significant uncertainty following the UK's vote to leave the European Union (EU). We have plans in place to ensure that we're prepared for the final outcome of negotiations between the UK and the EU, including the possibility of a no deal Brexit. Our contingency planning is focussed on ensuring we can continue to provide uninterrupted service to our customers, including maintaining sufficient inventory to protect against potential import delays.

Key operational metrics for the second quarter to 30 September

Our key operational metrics are as follows:

| Second quarter to 30 September | 2018 | 2017 |
|--|--------|--------|
| Consumer | | |
| Average revenue per customer (£ per month) | | |
| - Fixed | 38.3 | 37.8 |
| - Postpaid mobile | 22.0 | 22.1 |
| - Prepaid mobile | 8.3 | 8.2 |
| Monthly churn | | |
| - Fixed | 1.6% | 1.4% |
| - Postpaid mobile | 1.2% | 1.1% |
| Fibre share of broadband base | | |
| - Superfast | 68.4% | 59.7% |
| Business and Public Sector | | |
| Number of products/customers ('000) | | |
| - Voice lines | 2,098 | 2,353 |
| - VoIP seats | 304 | 243 |
| - Broadband lines | 782 | 814 |
| - WAN | 69 | 74 |
| - Mobile customers | 3,617 | 3,507 |
| Fibre share of broadband base | | |
| - Superfast | 51.6% | 44.1% |
| Rolling 12-month order intake (£m) | 2,786 | 3,782 |
| Wholesale and Ventures | | |
| Number of products/customers | | |
| - Wholesale call minutes (millions) | 928 | 1,105 |
| - External broadband circuits ('000) | 741 | 780 |
| - Ethernet circuits ('000) | 48 | 46 |
| - Partial private circuits (PPC) ('000) | 14 | 21 |
| - MVNO customers ('000) | 3,728 | 3,684 |
| Fibre share of broadband base | | |
| - Superfast | 34.6% | 28.9% |
| Wholesale rolling 12-month order intake (£m) | 1,133 | 1,538 |
| Global Services | | |
| Rolling 12-month order intake (£m) | 3,542 | 3,871 |
| Openreach | | |
| Network deployment ('000 premises passed) | | |
| Superfast inc. ultrafast | 27,220 | 26,382 |
| - of which ultrafast Gfast | 1,290 | 214 |
| - of which ultrafast FTTP | 682 | 431 |

OUTLOOK

There is no change to our financial outlook for 2018/19 from that published on 25 June (which reflected the adoption of the IFRS 15 accounting standard). Based on current trading, we expect EBITDA to be in the upper half of our £7.3 - £7.4 billion range.

| | 2018/19 |
|---|-----------------|
| Change in underlying¹ revenue (IFRS 15 basis) | Down c.2% |
| Adjusted¹ EBITDA (IFRS 15 basis) | £7.3bn - £7.4bn |
| Normalised free cash flow¹ | £2.3bn - £2.5bn |
| Capital expenditure (excluding BDUK clawback) | c.£3.7bn |

¹ See glossary on page 2

DIVIDEND POLICY

As announced at our Q2 results presentation last year, from this financial year, the interim dividend will be fixed at 30% of the prior year's full-year dividend. As a result, BT is declaring an interim dividend of 4.62 pence per share, which is 30% of last year's full-year dividend of 15.4 pence per share.

The Board continues to expect to hold the full-year dividend unchanged at 15.4 pence per share for this financial year and next, given our current performance and outlook for earnings and cash flow over this period.

The Board remains committed to our dividend policy, which is to maintain or grow the dividend each year whilst reflecting a number of factors including underlying medium term earnings expectations and levels of business reinvestment.

The interim dividend will be paid on 4 February 2019 to shareholders on the register on 28 December 2018. The ex-dividend date is 27 December 2018. The election date for participation in BT's Dividend Investment Plan in respect of this dividend is 28 December 2018. The final dividend for the year to 31 March 2018 of 10.55p, amounting to £1,045m, was approved at the Annual General Meeting on 11 July 2018 and paid on 3 September 2018.

Group results for the half year to 30 September 2018

Revenue and EBITDA

Reported revenue was £11,588m, down 2%, and adjusted¹ revenue was down 1%² as growth in our consumer business was more than offset by regulated price reductions in Openreach and declines in our enterprise businesses. The main contributor to enterprise revenue decline was Global Services whose adjusted¹ revenue declined 7%² due to a reduction in IP exchange volumes in line with our strategy to reduce low margin business and the impact of foreign exchange.

Adjusted¹ operating costs were down 3% mainly driven by restructuring related cost savings, partly offset by higher costs of recruiting and training new engineers to support Openreach's 'Fibre First' programme. Adjusted¹ EBITDA of £3,675m was up 2%² primarily driven by higher volume and mix in our high-end smartphones in our consumer business and cost efficiencies from our cost transformation programmes, partly offset by the decline in revenue and higher costs of investment in customer experience. Reported profit before tax was up 24% at £1,340m, primarily driven by higher specific item costs in the prior year. Adjusted¹ profit before tax was up 4%² at £1,657m.

Specific items (Note 6 to the condensed consolidated financial statements)

Specific items resulted in a net charge after tax of £265m (H1 2017/18: £450m). The main components include restructuring costs of £206m (H1 2017/18: £130m), costs relating to regulatory matters of £41m (H1 2017/18: £27m) and interest expense on pensions of £69m (H1 2017/18: £109m). Our prior half year also included £225m relating to the settlement of warranty claims arising under the 2015 EE acquisition agreement.

Tax

The effective tax rate was 21.5% on reported profit and 20.5% on profit before specific items, based on our current estimated effective tax rate for the full year. This is higher than the standard UK corporation tax rate of 19% principally due to non-deductible items, including share-based payments.

Capital expenditure

Capital expenditure was £1,833m (H1 2017/18: £1,693m) including network investment of £988m, up 15% due to an increase in our base-case assumption for customer take-up under the Broadband Delivery UK (BDUK) programme partly offset by lower mobile investment as the Emergency Services Network (ESN) passed the peak deployment phase. Excluding the effect of the change in our base-case assumption for BDUK capital expenditure was £1,663m. Other capital expenditure components were up 1% with £443m spent on customer driven investments, £327m on systems and IT, and £75m spent on non-network infrastructure.

Under the terms of the BDUK programme, we have an obligation to repay or re-invest grant funding depending on factors including the level of customer take-up achieved. Following sign up of the majority of its major and a number of its smaller communications providers to Openreach's pricing discounts for volume commitments in the quarter, we have reassessed our base-case assumption for take-up in BDUK areas. Based on the greater certainty provided by the volume commitments we have increased the take-up assumption from 41% to 61% of total premises passed, reflecting a life-time view of the BDUK programme. The gainshare provision increased by £176m in the half year to £712m, primarily driven by the take-up assumption change.

Free cash flow

Net cash inflow from operating activities was down £1,831m at £754m mainly driven by £2bn contributions to the BT Pension Scheme. Normalised free cash flow¹ was down £271m at £974m driven by increased cash capital expenditure, timing of working capital movements and the settlement of the Phones4U dispute relating to the retail trading agreement, partly offset by the increase in EBITDA. A reconciliation to our free cash flow is shown in Additional Information on page 33.

The net cash cost of specific items was £277m (H1 2017/18: £589m). This includes restructuring payments of £190m (H1 2017/18: £111m) and regulatory payments of £51m (H1 2017/18: £197m). Our prior year also included payments of £225m relating to the settlement of warranty claims arising under the 2015 EE acquisition agreement.

¹ See Glossary on page 2

² Measured against IFRS 15 pro forma comparative period in the prior year

Net debt and liquidity

Net debt¹ was £11,895m at 30 September 2018, £2,268m higher than at 31 March 2018, primarily reflecting the £754m of net cash inflow from operating activities offset by £2bn pension deficit payment and £1bn dividend payment. The deficit payment was funded by £2bn of new bonds issued under our €20bn Euro Medium Term Note programme to the BT Pension Scheme. These are sterling denominated with maturities ranging from 2033 to 2042. On 26 September £0.9bn of new bonds were issued for general corporate purposes with maturities ranging from 2023 to 2028. On 3 August £0.5bn of debt was repaid at maturity.

At 30 September 2018 the group held £3.8bn of cash and current investment balances. £2.4bn of short term borrowings include term debt of £1.8bn, repayable during 2018/19, and £0.6bn collateral for open mark to market positions and overdrafts. Our £2.1bn facility, which matures in September 2021, remains undrawn at 30 September 2018.

Pension (Note 7 to the condensed consolidated financial statements)

The IAS 19 net pension position at 30 September 2018 was a deficit of £4.5bn net of tax (£5.3bn gross of tax), compared with £5.7bn net of tax (£6.8bn gross of tax) at 31 March 2018. The reduction in the gross deficit of £1.5bn since 31 March 2018 mainly reflects deficit contributions of £2bn offset by lower than expected asset returns and actuarial movements.

The increase in the deficit compared to 30 June 2018 (£3.9bn net of tax; £4.6bn gross of tax) mainly reflects a fall in the real discount rate and lower than expected asset returns.

In October, we appealed a January 2018 High Court judgement which determined that it is not currently possible to change the index used for calculating pension increases for BTPS Section C members from RPI, and are awaiting the outcome.

On 26 October, the High Court handed down a judgment involving the Lloyds Banking Group's defined benefit pension schemes. The judgment concluded the schemes should be amended to equalise pension benefits for men and women in relation to guaranteed minimum pension benefits. The issues determined by the judgment arise in relation to many other defined benefit pension schemes. We are working with the trustees of our pension schemes, and our actuarial and legal advisers, to understand the extent to which the judgment crystallises additional liabilities for BT's pension schemes. We estimate this could be in the hundreds of millions of pounds, and any adjustment necessary is expected to be recognised in the second half of 2018/19.

Principal risks and uncertainties

A summary of the Group's principal risks and uncertainties is provided in note 14.

¹ See Glossary on page 2

² Measured against IFRS 15 pro forma comparative period in the prior year

Operating review

Consumer

| | Second quarter to 30 September ¹ | | | | Half year to 30 September ¹ | | | |
|-----------------------------|---|------------------------------|--------|---|--|-------|--------|------|
| | 2018 | 2017 | Change | | 2018 | 2017 | Change | |
| | £m | (IFRS 15) ² £m | £m | % | £m | £m | £m | % |
| Revenue | 2,681 | 2,587 | 94 | 4 | 5,272 | 5,127 | 145 | 3 |
| Operating costs | 2,070 | 2,012 | 58 | 3 | 4,051 | 3,996 | 55 | 1 |
| EBITDA | 611 | 575 | 36 | 6 | 1,221 | 1,131 | 90 | 8 |
| Depreciation & amortisation | | | | | 508 | 485 | 23 | 5 |
| Operating profit | | | | | 713 | 646 | 67 | 10 |
| Capital expenditure | | | | | 401 | 461 | (60) | (13) |
| Normalised free cash flow | | | | | 677 | 663 | 14 | 2 |

Revenue growth for the half year was driven by a higher volume and mix of high-end smartphones, improved mix of direct distribution, 'more for more' pricing in broadband and mobile, growth in the SIM only base across all the brands and all customers now paying for BT Sport. This was partially offset by solus voice reductions.

EBITDA grew, driven by the revenue growth and supplier rebates in the period, partially offset by increased contractual UEFA sports rights costs.

Capital expenditure was down 13% as ESN passed the peak deployment phase. Normalised free cash flow was £677m, up 2% on last year as the increase in EBITDA and reduction in capital expenditure were offset mainly by the settlement of the Phones4U dispute relating to the retail trading agreement.

Mobile churn remained consistent with previous quarters at 1.2%. Fixed churn increased to 1.6% reflecting both competitive conditions in the broadband market and a one-off effect from our price rise notification.

We've agreed a long term extension to our content supply agreement with Sky. We've also partnered with John Lewis and Amazon to grow our indirect mobile distribution channel.

BT Plus, our first Consumer converged offering, continues to see good sales momentum and now has around half a million subscribers, many of whom are taking a mobile product.

¹ Adjusted. See Glossary on page 2

² IFRS 15 pro forma used for comparative period in the prior year

Business and Public Sector

| | Second quarter to 30 September ¹ | | | | Half year to 30 September ¹ | | | |
|-----------------------------------|---|------------------------------|--------|-----|--|------------------------------|--------|------|
| | 2018 | 2017 | Change | | 2018 | 2017 | Change | |
| | £m | (IFRS 15) ² £m | £m | % | £m | (IFRS 15) ² £m | £m | % |
| Revenue | 1,110 | 1,143 | (33) | (3) | 2,195 | 2,275 | (80) | (4) |
| - underlying revenue ³ | | | | (3) | | | | (4) |
| Operating costs | 752 | 789 | (37) | (5) | 1,487 | 1,579 | (92) | (6) |
| EBITDA | 358 | 354 | 4 | 1 | 708 | 696 | 12 | 2 |
| Depreciation & amortisation | | | | | 179 | 185 | (6) | (3) |
| Operating profit | | | | | 529 | 511 | 18 | 4 |
| Capital expenditure | | | | | 136 | 152 | (16) | (11) |
| Normalised free cash flow | | | | | 514 | 479 | 35 | 7 |

Revenue decreased for the half year mainly due to the ongoing decline in fixed voice where revenues declined 9%, broadly in line with an 11% decline in our traditional lines base. This was partially offset by growth in IP, Mobile and Networking. Mobile grew 2% as the effects of Roam Like at Home dropped away and steady growth in the base.

Operating costs reduced, helped by labour cost efficiencies from our cost transformation programmes. EBITDA grew, with our lower cost base offsetting the reduction in revenue, as well as some one-off cost benefits in the first quarter.

Capital expenditure decreased 11% due to lower network and integration costs. Normalised free cash flow increased 7%, reflecting the increase in EBITDA and the timing of working capital inflows.

Around 40% of our SME broadband sales are now with 4G Assure, the UK's first broadband that can automatically switch to 4G, which is well ahead of our expectations and we have continued to grow the proportion of fibre customers within our broadband base, with more than half our broadband customers now on fibre.

Order intake decreased 32% to £1.3bn for H1 and was down 26% to £2.8bn on a rolling 12-month basis, due to the signing of a large Wholesale contract in the Republic of Ireland in the prior year.

¹ Adjusted. See Glossary on page 2

² IFRS 15 pro forma used for comparative period in the prior year

³ Underlying revenue excludes acquisitions, disposals and foreign exchange

Wholesale and Ventures

| | Second quarter to 30 September ¹ | | | | Half year to 30 September ¹ | | | |
|-----------------------------|---|------------------------------|--------|------|--|------------------------------|--------|------|
| | 2018 | 2017 | Change | | 2018 | 2017 | Change | |
| | £m | (IFRS 15) ² £m | £m | % | £m | (IFRS 15) ² £m | £m | % |
| Revenue | 470 | 510 | (40) | (8) | 929 | 1,007 | (78) | (8) |
| Operating costs | 299 | 320 | (21) | (7) | 604 | 643 | (39) | (6) |
| EBITDA | 171 | 190 | (19) | (10) | 325 | 364 | (39) | (11) |
| Depreciation & amortisation | | | | | 152 | 154 | (2) | (1) |
| Operating profit | | | | | 173 | 210 | (37) | (18) |
| Capital expenditure | | | | | 106 | 106 | - | - |
| Normalised free cash flow | | | | | 160 | 212 | (52) | (25) |

Revenue was down 8% for the half year. Wholesale revenue was down 11% driven by lower voice usage and customers migrating to newer IP technologies, ongoing price competition in the wholesale broadband market, a decline in the broadband base and the ongoing migration of customers from Partial Private Circuits (PPCs) to newer technologies.

Our Ventures businesses performed well with revenue growth of 11%, mainly driven by growth in messaging services and new external deals in Supply Chain. We continue to rollout InLinkUK with 286 installed units as at the end of September and over 100 installed in Q2 alone.

Operating costs were down 6% and EBITDA decreased 11% reflecting the revenue decline, particularly in higher margin legacy services.

Capital expenditure was flat and normalised free cash flow was £160m, down 25% on last year mainly reflecting the EBITDA decline.

Our Wholesale order intake of £0.3bn for the half year was down 35%. On a 12-month rolling basis order intake was down 26% to £1.1bn as last year benefitted from the five-year wholesale mobile network services deal with Virgin Media.

¹ Adjusted. See Glossary on page 2

² IFRS 15 pro forma used for comparative period in the prior year

Global Services

| | Second quarter to 30 September ¹ | | | | Half year to 30 September ¹ | | | |
|-----------------------------------|---|------------------------------|--------|-----|--|------------------------------|--------|------|
| | 2018 | 2017 | Change | | 2018 | 2017 | Change | |
| | £m | (IFRS 15) ² £m | £m | % | £m | (IFRS 15) ² £m | £m | % |
| Revenue | 1,185 | 1,265 | (80) | (6) | 2,332 | 2,511 | (179) | (7) |
| - underlying revenue ³ | | | | (5) | | | | (6) |
| Operating costs | 1,072 | 1,184 | (112) | (9) | 2,124 | 2,357 | (233) | (10) |
| EBITDA | 113 | 81 | 32 | 40 | 208 | 154 | 54 | 35 |
| Depreciation & amortisation | | | | | 186 | 221 | (35) | (16) |
| Operating profit (loss) | | | | | 22 | (67) | 89 | 133 |
| Capital expenditure | | | | | 99 | 128 | (29) | (23) |
| Normalised free cash flow | | | | | (44) | (133) | 89 | 67 |

In line with our strategy to de-emphasise low margin business, revenue for the half year was down 7% including a £39m negative impact from foreign exchange movements.

Operating costs for the half year were down 10% mainly reflecting the decline in IP Exchange volumes and equipment sales and lower labour costs in line with our strategy to transform our operating model. EBITDA for the half year was up £54m as lower revenues were more than offset by the reduction in operating costs and certain one-offs.

Depreciation and amortisation was down 16% for the half year due to the timing of certain projects in the prior year. Operating profit for the half year was £22m.

Capital expenditure was down 23% for the half year reflecting ongoing rationalisation and including deferral of spend into the second half of the year. Normalised free cash flow for the half year improved by £89m to an outflow of £44m, reflecting the higher EBITDA and lower capital expenditure.

The total order intake in the half year was £1.4bn, down 18%. On a rolling 12-month basis it was £3.5bn, down 8% year on year continuing to reflect a shift in buyer behaviour, including shorter contract lengths and increased usage-based terms.

¹ Adjusted. See Glossary on page 2

² IFRS 15 pro forma used for comparative period in the prior year

³ Underlying revenue excludes acquisitions, disposals and foreign exchange

Openreach

| | Second quarter to 30 September ¹ | | | | Half year to 30 September ¹ | | | |
|-----------------------------|---|------------------------------|--------|-----|--|------------------------------|--------|------|
| | 2018 | 2017 | Change | | 2018 | 2017 | Change | |
| | £m | (IFRS 15) ² £m | £m | % | £m | (IFRS 15) ² £m | £m | % |
| Revenue | 1,255 | 1,261 | (6) | - | 2,472 | 2,509 | (37) | (1) |
| Operating costs | 645 | 632 | 13 | 2 | 1,295 | 1,259 | 36 | 3 |
| EBITDA | 610 | 629 | (19) | (3) | 1,177 | 1,250 | (73) | (6) |
| Depreciation & amortisation | | | | | 679 | 690 | (11) | (2) |
| Operating profit | | | | | 498 | 560 | (62) | (11) |
| Capital expenditure | | | | | 1,031 | 787 | 244 | 31 |
| Normalised free cash flow | | | | | 259 | 501 | (242) | (48) |

Revenue decline for the half year was driven by around £150m of regulated price reductions on FTTC and Ethernet products, £30m of non-regulated price reductions mainly driven by a number of major and smaller communications providers that have signed up to our pricing discounts offer for volume commitments, and a decline in our physical line base. This was partly offset by underlying growth of 25% in our FTTC rental base and a 10% increase in our Ethernet rental base.

Operating costs were 3% higher mainly driven by higher costs from recruitment and training of new engineers to support our 'Fibre First' programme and help deliver improved customer service, pay inflation and business rates, partly offset by efficiency savings. EBITDA was down 6% for the half year.

Capital expenditure was £1,031m, up £244m or 31%, driven by higher year on year BDUK net grant funding deferrals and investment in our FTTP and Gfast network build being partly offset by efficiency savings.

Normalised free cash flow was down 48% due to the EBITDA decline, higher underlying capital expenditure (excluding BDUK grant funding deferrals) and timing of customer receipts.

¹ Adjusted. See Glossary on page 2

² IFRS 15 pro forma used for comparative period in the prior year

Financial statements

Group income statement

For the half year to 30 September 2018 (IFRS 15 basis)

| | Note | Before specific items (‘Adjusted’) | Specific items (note 6) | Total (Reported) |
|---|------|---|-------------------------------|---------------------|
| | | £m | £m | £m |
| Revenue | 3,4 | 11,624 | (36) | 11,588 |
| Operating costs | 5 | (9,685) | (212) | (9,897) |
| Operating profit | | 1,939 | (248) | 1,691 |
| Finance expense | | (295) | (69) | (364) |
| Finance income | | 12 | - | 12 |
| Net finance expense | | (283) | (69) | (352) |
| Share of post tax profit of associates and joint ventures | | 1 | - | 1 |
| Profit before tax | | 1,657 | (317) | 1,340 |
| Tax | | (340) | 52 | (288) |
| Profit for the period | | 1,317 | (265) | 1,052 |
| Earnings per share | | | | |
| - basic | | 13.3p | (2.7)p | 10.6p |
| - diluted | | 13.2p | (2.7)p | 10.5p |

Group income statement

For the half year to 30 September 2017 (IAS 18 basis)

| | Note | Before specific items (‘Adjusted’) | Specific items (note 6) | Total (Reported) |
|---|------|---|-------------------------------|---------------------|
| | | £m | £m | £m |
| Revenue | 3,4 | 11,800 | (14) | 11,786 |
| Operating costs | 5 | (9,961) | (373) | (10,334) |
| Operating profit | | 1,839 | (387) | 1,452 |
| Finance expense | | (263) | (109) | (372) |
| Finance income | | 4 | - | 4 |
| Net finance expense | | (259) | (109) | (368) |
| Share of post tax profit of associates and joint ventures | | - | - | - |
| Profit before tax | | 1,580 | (496) | 1,084 |
| Tax | | (321) | 46 | (275) |
| Profit for the period | | 1,259 | (450) | 809 |
| Earnings per share | | | | |
| - basic | | 12.7p | (4.5)p | 8.2p |
| - diluted | | 12.7p | (4.5)p | 8.2p |

Group statement of comprehensive income

| | Half year to 30 September | |
|--|------------------------------|------------------------|
| | 2018 (IFRS 15) £m | 2017 (IAS 18) £m |
| Profit for the period | 1,052 | 809 |
| Other comprehensive income (loss) | | |
| Items that will not be reclassified to the income statement: | | |
| Remeasurements of the net pension obligation | (292) | (4) |
| Tax on pension remeasurements | 58 | 17 |
| Items that have been or may be reclassified subsequently to the income statement: | | |
| Exchange differences on translation of foreign operations | 74 | (114) |
| Fair value movements on available-for-sale assets | 5 | 4 |
| Fair value movements on cash flow hedges: | | |
| - net fair value (losses) gains | 477 | (49) |
| - recognised in income and expense | (293) | 78 |
| Movement on cost of hedging reserve | (90) | - |
| Tax on components of other comprehensive income that have been or may be reclassified | (30) | (9) |
| Other comprehensive profit (loss) for the period, net of tax | (91) | (77) |
| Total comprehensive income for the period | 961 | 732 |

Group balance sheet

| | 30 September 2018 (IFRS 15) | 31 March 2018 (IAS 18) (restated) ¹ |
|--|-----------------------------------|---|
| | £m | £m |
| Non-current assets | | |
| Intangible assets | 14,610 | 14,447 |
| Property, plant and equipment | 17,234 | 17,000 |
| Derivative financial instruments | 1,467 | 1,312 |
| Investments | 59 | 53 |
| Associates and joint ventures | 43 | 38 |
| Trade and other receivables | 436 | 317 |
| Contract assets ² | 239 | - |
| Deferred tax assets | 1,003 | 1,326 |
| | 35,091 | 34,493 |
| Current assets | | |
| Programme rights | 727 | 272 |
| Inventories | 305 | 239 |
| Trade and other receivables | 3,554 | 4,014 |
| Contract assets ² | 1,321 | - |
| Assets held for sale | 88 | - |
| Current tax receivable | 77 | 77 |
| Derivative financial instruments | 311 | 197 |
| Investments | 3,359 | 3,022 |
| Cash and cash equivalents | 431 | 528 |
| | 10,173 | 8,349 |
| Current liabilities | | |
| Loans and other borrowings | 2,813 | 2,281 |
| Derivative financial instruments | 53 | 50 |
| Trade and other payables | 5,721 | 7,168 |
| Contract liabilities ² | 1,343 | - |
| Current tax liabilities | 211 | 83 |
| Provisions | 607 | 603 |
| | 10,748 | 10,185 |
| Total assets less current liabilities | 34,516 | 32,657 |
| Non-current liabilities | | |
| Loans and other borrowings | 14,256 | 11,994 |
| Derivative financial instruments | 706 | 787 |
| Contract liabilities ² | 121 | - |
| Retirement benefit obligations | 5,280 | 6,847 |
| Other payables | 1,563 | 1,326 |
| Deferred tax liabilities | 1,176 | 1,340 |
| Provisions | 486 | 452 |
| | 23,588 | 22,746 |
| Equity | | |
| Share capital | 499 | 499 |
| Share premium | 1,051 | 1,051 |
| Own shares | (171) | (186) |
| Merger reserve | 4,147 | 6,647 |
| Other reserves | 677 | 534 |
| Retained earnings | 4,725 | 1,366 |
| Total equity | 10,928 | 9,911 |
| | 34,516 | 32,657 |

¹ Restatement to reflect the update to our retirement benefit obligation. See Note 2 to the condensed consolidated financial statements

² Contract assets and contract liabilities arise following the adoption of IFRS 15 on 1 April 2018. See Note 1 to the condensed consolidated financial statements

Group statement of changes in equity

For the half year to 30 September 2018 (IFRS 15 basis)

| | Share Capital | Share Premium | Own Shares | Merger Reserve | Other Reserves | Retained Earnings | Total Equity |
|---|------------------|------------------|---------------|-------------------|-------------------|----------------------|-----------------|
| | £m | £m | £m | £m | £m | £m | £m |
| At 31 March 2018 – as published | 499 | 1,051 | (186) | 6,647 | 534 | 1,759 | 10,304 |
| Pension restatement ¹ | - | - | - | - | - | (393) | (393) |
| At 31 March 2018 – restated | 499 | 1,051 | (186) | 6,647 | 534 | 1,366 | 9,911 |
| IFRS opening balance adjustment ² | - | - | - | - | - | 1,308 | 1,308 |
| Tax on IFRS opening balance adjustment ² | - | - | - | - | - | (248) | (248) |
| At 1 April 2018 | 499 | 1,051 | (186) | 6,647 | 534 | 2,426 | 10,971 |
| Profit for the period | - | - | - | - | - | 1,052 | 1,052 |
| Other comprehensive income (loss) before tax | - | - | - | - | 556 | (292) | 264 |
| Movements on cost of hedging reserve | - | - | - | - | (90) | - | (90) |
| Tax on other comprehensive (loss) income | - | - | - | - | (30) | 58 | 28 |
| Transferred to the income statement | - | - | - | - | (293) | - | (293) |
| Comprehensive income | - | - | - | - | 143 | 818 | 961 |
| Transfer to realised profit | - | - | - | (2,500) | - | 2,500 | - |
| Dividends to shareholders | - | - | - | - | - | (1,045) | (1,045) |
| Share-based payments | - | - | - | - | - | 36 | 36 |
| Net buyback of own shares | - | - | 15 | - | - | (22) | (7) |
| Unclaimed dividends over 10 years | - | - | - | - | - | 14 | 14 |
| Other movements | - | - | - | - | - | (2) | (2) |
| At 30 September 2018 | 499 | 1,051 | (171) | 4,147 | 677 | 4,725 | 10,928 |

¹ See Note 2 to the condensed consolidated financial statements

² See Note 1 to the condensed consolidated financial statements

For the half year to 30 September 2017 (IAS 18 basis)

| | | | | | | | |
|--|------------|--------------|--------------|--------------|------------|--------------|--------------|
| At 1 April 2017 | 499 | 1,051 | (96) | 6,647 | 884 | (650) | 8,335 |
| Profit for the period | - | - | - | - | - | 809 | 809 |
| Other comprehensive loss before tax | - | - | - | - | (159) | (4) | (163) |
| Tax on other comprehensive (loss) income | - | - | - | - | (9) | 17 | 8 |
| Transferred to the income statement | - | - | - | - | 78 | - | 78 |
| Comprehensive (loss) income | - | - | - | - | (90) | 822 | 732 |
| Dividends to shareholders | - | - | - | - | - | (1,044) | (1,044) |
| Share-based payments | - | - | - | - | - | 40 | 40 |
| Net buyback of own shares | - | - | (112) | - | - | (63) | (175) |
| Other movements | - | - | - | - | - | 2 | 2 |
| At 30 September 2017 | 499 | 1,051 | (208) | 6,647 | 794 | (893) | 7,890 |

Group cash flow statement

For the second quarter and half year to 30 September

| | Half year to 30 September | |
|--|------------------------------|------------------------|
| | 2018 (IFRS 15) £m | 2017 (IAS 18) £m |
| Cash flow from operating activities | | |
| Profit before tax | 1,340 | 1,084 |
| Share-based payments | 36 | 40 |
| Profit on disposal of subsidiaries and interest in associates | - | (1) |
| Share of post tax losses of associates and joint ventures | (1) | - |
| Net finance expense | 352 | 368 |
| Depreciation and amortisation | 1,736 | 1,757 |
| (Increase) decrease in working capital | (490) | (410) |
| Provisions, pensions and other non-cash movements ¹ | (2,009) | (72) |
| Cash inflow (outflow) from operating activities² | 964 | 2,766 |
| Tax paid | (210) | (181) |
| Net cash inflow (outflow) from operating activities | 754 | 2,585 |
| Cash flow from investing activities | | |
| Interest received | 8 | 2 |
| Acquisition of subsidiaries ³ , associates and joint ventures | (6) | (20) |
| Proceeds on disposal of subsidiaries | - | 2 |
| Purchases of property, plant and equipment and software | (1,739) | (1,665) |
| Proceeds on disposal of property, plant and equipment | 3 | 11 |
| Purchase of non-current asset investments | - | - |
| Purchases of current financial assets | (6,721) | (5,892) |
| Proceeds on disposal of current financial assets | 6,395 | 4,853 |
| Net cash inflow (outflow) from investing activities | (2,060) | (2,709) |
| Cash flow from financing activities | | |
| Interest paid | (236) | (259) |
| Equity dividends paid | (1,040) | (1,038) |
| Proceeds from bank loans and bonds | 2,896 | 2,029 |
| Repayment of borrowings ⁴ | (480) | (502) |
| Cash flows from derivatives related to net debt | 59 | (132) |
| Proceeds from issue of own shares | 2 | 46 |
| Repurchase of ordinary share capital | (9) | (221) |
| Net cash inflow (outflow) from financing activities | 1,192 | (77) |
| Net increase (decrease) in cash and cash equivalents | (114) | (201) |
| Opening cash and cash equivalents | 499 | 511 |
| Net (decrease) increase in cash and cash equivalents | (114) | (201) |
| Effect of exchange rate changes | 7 | (19) |
| Closing cash and cash equivalents⁵ | 392 | 291 |

¹ Includes pension deficit payments of £2,012m for the half year to 30 September 2018 (H1 2017/18: £10m)

² Includes cash flows relating to TV programme rights

³ Prior year includes a true up of consideration following the audit of the completion balance sheet relating to the acquisition of EE

⁴ Repayment of borrowings includes the impact of hedging and repayment of lease liabilities

⁵ Net of bank overdrafts of £39m at 30 September 2018 (30 September 2017: £62m; 31 March 2018: £29m)

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 half years to 30 September 2018 and 30 September 2017 together with the balance sheet at 31 March 2018. The financial statements for the half year to 30 September 2018 have been reviewed by the auditors and their review opinion is on page 31. The financial statements have been prepared in accordance with the Disclosure Guidance and Transparency Rules sourcebook (DTR) of the Financial Conduct 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 Report & Form 20-F 2018 and Annual Report & Form 20-F(A) 2018 ('Annual Report 2018') which was prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. In preparing the group financial statements, the directors have also elected to comply with IFRS, issued by the International Accounting Standards Board (IASB).

Having assessed the principal risks, the directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Except as described below and other than income taxes which are accrued using the tax rate that is expected to be applicable for the full financial year, 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 2018 and have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value.

The comparative figures for the financial year ended 31 March 2018 are not the company's statutory accounts for that financial year. Those accounts have been reported on by the company's auditor and delivered to the registrar of companies. The report of the auditor was unqualified, did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report, and did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

New and amended accounting standards effective during the year

The following standards have been issued and were effective for BT Group from 1 April 2018:

IFRS 15 'Revenue from contracts with customers'

Background

IFRS 15 sets out the requirements for recognising revenue and costs from contracts with customers and includes extensive disclosure requirements. The standard requires entities to apportion revenue earned from contracts to individual performance obligations, on a relative stand-alone selling price basis, based on a five-step model.

As disclosed in our Annual Report 2018 we have adopted the standard on a modified retrospective basis and have recognised the cumulative effective of initially applying the standard as an adjustment to the opening balance of retained earnings at 1 April 2018. Under this transition method:

- the standard has been applied only to contracts in progress but not completed at the date of initial application;
- for contracts that were modified before 1 April 2018, we have reflected the aggregate effect of all of the modifications that occur before this date at 1 April 2018;
- we have not restated prior year comparatives for the effect of IFRS 15 but have instead restated our 1 April 2018 opening retained earnings for the full cumulative impact of adopting this standard; and
- for the year ended 31 March 2019 we will provide a reconciliation of our primary financial statements under IFRS 15 to those in accordance with IAS 18 in our Annual Report & Form 20-F 2019.

Financial impact

In our Annual Report 2018 we estimated that the likely impact on transition at 1 April 2018 would produce a cumulative increase in retained earnings of between £1.1bn and £1.5bn before tax. The actual increase of £1.3bn before tax (£1.1bn after tax) has primarily been recorded as a contract asset and will lead to an additional one-off cash tax payment of £0.2bn equally split between 2018/19 and 2019/20. The cumulative increase in retained earnings is mainly due to the acceleration of handset revenues and, to a lesser extent, deferral of costs (notably third party contract acquisition costs primarily associated with post pay mobile contracts).

The financial impact of each business area is as follows:

- Under our previous accounting policy, mobile handset revenue was recognised based on the amount the customer pays for the handset when it is delivered to the customer. Generally mobile handsets are either provided free or for a small upfront charge. Under IFRS 15, additional revenue is allocated to the mobile handset at the start of the contract. This is calculated with reference to its relative standalone value within the contract, regardless of the contract pricing. For each mobile handset contract the revenue recognition profile changed with greater day one recognition of revenue for the handset and a

corresponding reduction in ongoing mobile service revenue over the contract period. The difference between the mobile handset revenue recognised and the amounts charged to the customer has been recognised as a contract asset. Over time, we expect the contract asset generated to remain at similar levels as old contracts expire and new ones are signed. However, we will see short-term volatility, for example around key handset launches. This primarily impacted Consumer, and to a lesser extent this also impacted mobile handset revenues in Business and Public Sector in respect of the legacy EE business division. We saw a similar trend in respect of subsidised equipment although this had a less significant impact due to the lower relative standalone value for this equipment.

– Previously, sales commissions and other third party acquisition costs resulting directly from securing contracts with customers were expensed when incurred. Under IFRS 15 sales commissions and other third party contract acquisition costs are recognised as an asset, and amortised over the period in which the corresponding benefit is received, resulting in earlier profit recognition. The impact is greatest in Consumer in respect of third-party acquisition costs.

– The above two impacts are partly offset by amended accounting for connections revenue. Previously, the group recognised connections revenue upon performance of the connection activity. Under IFRS 15 connections revenue is deferred and recognised on a straight-line basis over the associated line/circuit contractual period. This means that revenue and profits are recognised later. On transition this led to the recognition of a contract liability as revenue and profits are deferred to future periods. Wholesale and Ventures and Openreach deliver the majority of this service and therefore experienced the majority of the impact. Over time, this liability is expected to remain at similar levels as old contracts expire and new ones are signed.

– The IFRS 15 impact on other areas was not material. This included certain contract fulfilment costs which are recognised as an asset and amortised over the period in which benefit is received and certain expenses are recognised as a deduction from revenue.

Pro forma

We have prepared and published unaudited pro forma results for the years ended 31 March 2018 and 31 March 2017 under IFRS 15. While BT believes the pro forma information contained in this document to be reliable, BT does not warrant the accuracy, completeness or validity of the information, figures or calculations and shall not be liable in any way for loss or damage arising out of the use of the information, or any errors or omissions in its content.

IFRS 9 'Financial Instruments'

IFRS 9 is applicable to financial assets and financial liabilities and covers the classification, measurement, impairment and de-recognition of financial assets and liabilities together with a new hedge accounting model. The standard does not have a material impact on our results, with the key issues being the provision of expected lifetime losses on IFRS 15 contract assets, documentation of policies, hedging strategy and new hedge documentation.

There are no other new or amended standards or interpretations adopted during the year that have a significant impact on the group.

New and amended accounting standards that have been issued but are not yet effective

IFRS 16 'Leases'

We will report our financial statements under IFRS 16 from the first quarter of 2019/20. We expect to adopt IFRS 16 on a modified retrospective basis in our 2019/20 financial statements. Accordingly we will not restate prior year comparatives for the effect of IFRS 16 but will instead restate our 1 April 2019 opening reserves for the full cumulative impact of adopting this standard.

The standard requires lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less, or the underlying asset is of low value. We are still in the process of quantifying the implications of this standard. However, we expect the following indicative impacts:

- there is expected to be an increase in total assets, as leased assets which are currently accounted for off balance sheet (i.e. classified as operating leases under IAS 17) will be recognised on balance sheet and valued in accordance with the principles of IFRS 16. The biggest asset category impacted for the group is expected to be land and buildings
- there is expected to be an increase in debt, as liabilities relating to existing operating leases are recognised
- operating lease expenditure will be reclassified and split between depreciation and finance costs. Therefore EBITDA will increase. Future depreciation and finance costs are also expected to increase as a result of increased assets and liabilities
- there is an expected temporary reduction in profit after tax. This is expected to be driven by an increase in finance costs as a result of the new leases. These finance costs will have an accelerated profile which will reduce over a lease term
- there may be a corresponding effect on tax balances in relation to all of the above impacts.

This standard will require us to make key accounting judgements in particular around the likelihood of lease renewals. Details of our existing operating lease commitments at 31 March 2018 are set out in note 30 of our Annual Report 2018.

2 Restatement of prior period financial statements

IAS 19 accounting valuation of retirement benefit obligations

On 27 July 2018, we announced that we had been alerted to an error made by our independent external actuary in the actuary's calculation of our IAS 19 accounting valuation of retirement benefit obligations at 31 March 2018. Our independent external actuary is employed as an expert to calculate the IAS 19 accounting valuation on behalf of management. The error resulted from the incorrect application of changes to demographic assumptions. Management determined that the error was material with respect to our Group statement of comprehensive income and would require the Group to restate its previously issued consolidated financial statements for the year ended 31 March 2018.

The accounting error understated the net pension obligation, after tax, at 31 March 2018 by £393m (£476m gross of deferred tax) and overstated total equity in the balance sheet by £393m. The re-measurement gain of the net pension obligation recorded within the Group statement of comprehensive income for the year ended 31 March 2018 was overstated by £476m and tax expense on the pension re-measurement was overstated by £83m.

The error has no effect on the Group income statement or the Group cash flow statement or any amounts included in the financial statements for the years ending 31 March 2017 and 31 March 2016 or the six months to 30 September 2017. It also has no effect on the 2017 triennial funding valuation of the BT Pension Scheme, associated cash contributions or on the pension scheme members.

The impact of the retirement benefit obligation restatement and the IFRS 15 and IFRS 9 opening balance adjustments have been set out in the reconciliations below:

Group statement of other comprehensive income

| Year to 31 March 2018 | As published £m | Pensions adjustment £m | Restated £m |
|--|--------------------|------------------------------|----------------|
| Profit for the period | 2,032 | - | 2,032 |
| Other comprehensive income (loss) | | | |
| Items that will not be reclassified to the income statement: | | | |
| Remeasurements of the net pension obligation | 2,160 | (476) | 1,684 |
| Tax on pension remeasurements | (346) | 83 | (263) |
| Items that have been or may be reclassified subsequently to the income statement: | | | |
| Exchange differences on translation of foreign operations | (188) | - | (188) |
| Fair value movements on available-for-sale assets | 11 | - | 11 |
| Fair value movements on cash flow hedges: | | | |
| - net fair value (losses) gains | (368) | - | (368) |
| - recognised in income and expense | 277 | - | 277 |
| Movement on cost of hedging reserve | - | - | - |
| Tax on components of other comprehensive income that have been or may be reclassified | 1 | - | 1 |
| Other comprehensive profit (loss) for the period, net of tax | 1,547 | (393) | 1,154 |
| Total comprehensive income (loss) for the period | 3,579 | (393) | 3,186 |

Group balance sheet

| | At 31 March 2018 as published | Pension adjustment | At 31 March 2018 restated | IFRS ¹ adjustment | At 1 April 2018 |
|--|-------------------------------------|-----------------------|---------------------------------|---------------------------------|--------------------|
| | £m | £m | £m | £m | £m |
| Non-current assets | | | | | |
| Intangible assets | 14,447 | - | 14,447 | - | 14,447 |
| Property, plant and equipment | 17,000 | - | 17,000 | - | 17,000 |
| Trade and other receivables | 317 | - | 317 | 114 | 431 |
| Contract assets | - | - | - | 198 | 198 |
| Deferred tax assets | 1,243 | 83 | 1,326 | - | 1,326 |
| Other non-current assets | 1,403 | - | 1,403 | - | 1,403 |
| | 34,410 | 83 | 34,493 | 312 | 34,805 |
| Current assets | | | | | |
| Trade and other receivables | 4,014 | - | 4,014 | (337) | 3,677 |
| Contract assets | - | - | - | 1,417 | 1,417 |
| Cash and cash equivalents | 528 | - | 528 | - | 528 |
| Other current assets | 3,807 | - | 3,807 | - | 3,807 |
| | 8,349 | - | 8,349 | 1,080 | 9,429 |
| Current liabilities | | | | | |
| Loans and other borrowings | 2,281 | - | 2,281 | - | 2,281 |
| Trade and other payables | 7,168 | - | 7,168 | (1,409) | 5,759 |
| Contract liabilities | - | - | - | 1,406 | 1,406 |
| Current tax liabilities | 83 | - | 83 | 248 | 331 |
| Other current liabilities | 653 | - | 653 | - | 653 |
| | 10,185 | - | 10,185 | 245 | 10,430 |
| Total assets less current liabilities | 32,574 | 83 | 32,657 | 1,147 | 33,804 |
| Non-current liabilities | | | | | |
| Loans and other borrowings | 11,994 | - | 11,994 | - | 11,994 |
| Retirement benefit obligations | 6,371 | 476 | 6,847 | - | 6,847 |
| Other non-current liabilities | 3,905 | - | 3,905 | 87 | 3,992 |
| | 22,270 | 476 | 22,746 | 87 | 22,833 |
| Equity | | | | | |
| Share capital | 499 | - | 499 | - | 499 |
| All other reserves | 8,046 | - | 8,046 | - | 8,046 |
| Retained earnings | 1,759 | (393) | 1,366 | 1,060 | 2,426 |
| Total equity | 10,304 | (393) | 9,911 | 1,060 | 10,971 |
| | 32,574 | 83 | 32,657 | 1,147 | 33,804 |

Group statement of changes in equity

| | Share Capital | Share Premium | Own Shares | Merger Reserve | Other Reserves | Retained Earnings | Total Equity |
|---|------------------|------------------|---------------|-------------------|-------------------|----------------------|-----------------|
| | £m | £m | £m | £m | £m | £m | £m |
| At 31 March 2018 – as published | 499 | 1,051 | (186) | 6,647 | 534 | 1,759 | 10,304 |
| Pension restatement | - | - | - | - | - | (393) | (393) |
| At 31 March 2018 – restated | 499 | 1,051 | (186) | 6,647 | 534 | 1,366 | 9,911 |
| IFRS opening balance adjustment ¹ | - | - | - | - | - | 1,308 | 1,308 |
| Tax on IFRS opening balance adjustment ¹ | - | - | - | - | - | (248) | (248) |
| At 1 April 2018 | 499 | 1,051 | (186) | 6,647 | 534 | 2,426 | 10,971 |

¹ This reflects the opening balance sheet adjustment for both IFRS 15 and IFRS 9. See note 1 to the condensed consolidated financial statements

3 Operating results – by customer facing unit

| | External Revenue | Internal revenue | Group revenue | EBITDA ¹ | Operating profit |
|--|------------------|------------------|---------------|---------------------|------------------|
| Half year to 30 September 2018 (IFRS 15 basis) | £m | £m | £m | £m | £m |
| Consumer | 5,220 | 52 | 5,272 | 1,221 | 713 |
| Business and Public Sector ² | 2,140 | 55 | 2,195 | 708 | 529 |
| Wholesale and Ventures ² | 873 | 56 | 929 | 325 | 173 |
| Global Services | 2,332 | - | 2,332 | 208 | 22 |
| Openreach | 1,057 | 1,415 | 2,472 | 1,177 | 498 |
| Other | 2 | - | 2 | 36 | 4 |
| Intra-group items | - | (1,578) | (1,578) | - | - |
| Total adjusted³ | 11,624 | - | 11,624 | 3,675 | 1,939 |
| Specific items (note 6) | | | (36) | | (248) |
| Total | | | 11,588 | | 1,691 |
| Half year to 30 September 2017 (IAS 18 basis) | | | | | |
| Consumer (restated) ⁴ | 5,083 | 50 | 5,133 | 1,139 | 654 |
| Business and Public Sector | 2,224 | 57 | 2,281 | 694 | 509 |
| Wholesale and Ventures | 926 | 71 | 997 | 361 | 207 |
| Global Services | 2,506 | - | 2,506 | 154 | (67) |
| Openreach | 1,054 | 1,494 | 2,548 | 1,238 | 548 |
| Other | 7 | - | 7 | 10 | (12) |
| Intra-group items | - | (1,672) | (1,672) | - | - |
| Total adjusted³ | 11,800 | - | 11,800 | 3,596 | 1,839 |
| Specific items (note 6) | | | (14) | | (387) |
| Total | | | 11,786 | | 1,452 |

¹ For the reconciliation of adjusted EBITA see additional information on page 32

² From 1 October 2018 Business and Public Sector and Wholesale and Ventures will be brought together to form Enterprise. See note 13 for further information

³ See Glossary on page 2

⁴ Consumer results restated to reflect the bringing together of BT Consumer and EE with effect from 1 April 2018

4 Operating result – by type of revenue¹

| Half year to 30 September | 2018 (IFRS 15) £m | 2017 (IAS 18) £m |
|-----------------------------------|-------------------------|------------------------|
| ICT and managed networks | 2,203 | 2,256 |
| Fixed access subscription revenue | 4,641 | 4,814 |
| Mobile subscription revenue | 2,659 | 3,086 |
| Equipment and other services | 2,121 | 1,644 |
| Total adjusted² | 11,624 | 11,800 |
| Specific items (note 6) | (36) | (14) |
| Total | 11,588 | 11,786 |

¹ Prior year comparatives have been re-presented to reflect revised revenue type categories

² See Glossary on page 2

5 Operating costs

| | Half year to 30 September | |
|---|------------------------------|------------------------|
| | 2018 (IFRS 15) £m | 2017 (IAS 18) £m |
| Direct labour costs | 2,664 | 2,690 |
| Indirect labour costs | 472 | 451 |
| Leaver costs | 8 | 30 |
| Total labour costs | 3,144 | 3,171 |
| Capitalised labour | (729) | (668) |
| Net labour costs | 2,415 | 2,503 |
| Product costs and sales commissions ¹ | 2,172 | 2,153 |
| Payments to telecommunications operators | 1,073 | 1,207 |
| Property and energy costs | 661 | 649 |
| Network operating and IT costs | 508 | 476 |
| Programme rights charges | 403 | 377 |
| Other operating costs ¹ | 717 | 839 |
| Operating costs before depreciation, amortisation and specific items | 7,949 | 8,204 |
| Depreciation and amortisation | 1,736 | 1,757 |
| Total operating costs before specific items | 9,685 | 9,961 |
| Specific items (Note 6) | 212 | 373 |
| Total operating costs | 9,897 | 10,334 |

¹ Other operating costs have been disaggregated and re-presented for the half year to 30 September 2017

6 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'). Specific items are used to derive the adjusted results as presented in the accompanying consolidated income statement. Adjusted results are consistent with the way that financial performance is measured by management and assists in providing an additional analysis of the reporting trading results of the group. Specific items may not be comparable to similarly titled measures used by other companies. In determining whether an event or transaction is specific, management considers quantitative as well as qualitative factors. Examples of charges or credits meeting the above definition and which have been presented as specific items in the current and/or prior years include acquisitions/disposals of businesses and investments, retrospective regulatory matters, historical insurance or litigation claims, business restructuring programmes, asset impairment charges, property rationalisation programmes, net interest on pensions and the settlement of multiple tax years. In the event that items meet the criteria, which are applied consistently from year to year, they are treated as specific items.

| | Half year to 30 September | |
|---|------------------------------|------------|
| | 2018 £m | 2017 £m |
| Specific revenue | | |
| Retrospective regulatory matters | 36 | 14 |
| Specific revenue | 36 | 14 |
| Specific operating costs | | |
| Restructuring charge | 206 | 130 |
| Retrospective regulatory matters | 5 | 13 |
| Italian business investigation | 1 | 6 |
| EE acquisition warranty claims | - | 225 |
| Profit on disposal of business | - | (1) |
| Specific operating costs | 212 | 373 |
| Specific operating loss | 248 | 387 |
| Net interest expense on pensions | 69 | 109 |
| Net specific items charge before tax | 317 | 496 |
| Tax credit on specific items before tax | (52) | (46) |
| Net specific items charge after tax | 265 | 450 |

Restructuring charge

During the first half of the year we incurred charges of £206m (H1 2017/18: £130m), primarily relating to leaver costs. These costs reflect projects within our group-wide cost transformation programme, including those costs related to the integration of EE.

Retrospective regulatory matters

We've recognised a net charge of £41m (H1 2017/18: £27m) in relation to regulatory matters in the first half of this year. This reflects the completion of the majority of compensation payments to other communications providers in relation to Ofcom's March 2017 findings of its investigation into our historical practices on Deemed Consent by Openreach, and new matters arising. Of this, £36m is recognised in revenue and £5m in operating costs.

Italian business investigation

During the first half of the year we have incurred professional costs relating to the investigation of our Italian business of £1m (H1 2017/18: £6m).

Interest expense on retirement benefit obligation

During the first half of the year we incurred £69m (H1 2017/18: £109m) of interest costs in relation to our defined benefit pension obligations.

Tax on specific items

A tax credit of £52m (H1 2017/18: £46m) was recognised in relation to specific items.

EE acquisition warranty claims

In the prior year we reached settlements with Deutsche Telekom and Orange in respect of any warranty claims under the 2015 EE acquisition agreement, arising from the issues previously announced regarding our operations in Italy. This represents a full and final settlement of these issues and results in a specific item charge of £225m.

7 Pensions

| | 30 September 2018 | 31 March 2018 (restated) |
|---|---|---|
| | £bn | £bn |
| IAS 19 liabilities – BTPS | (55.6) | (56.2) |
| Assets – BTPS | 50.8 | 49.9 |
| Other schemes | (0.5) | (0.5) |
| Total IAS 19 deficit, gross of tax | (5.3) | (6.8) |
| Total IAS 19 deficit, net of tax | (4.5) | (5.7) |
| Discount rate (nominal) | 2.85% | 2.65% |
| Discount rate (real) | (0.39%) | (0.44)% |
| RPI inflation | 3.25% | 3.10% |
| CPI inflation | 1.0% below RPI until 31 March 2023 and 1.1% below RPI thereafter | 1.0% below RPI until 31 March 2023 and 1.1% below RPI thereafter |

8 Financial instruments and risk management

Fair value of financial assets and liabilities measured at amortised cost

At 30 September 2018, the fair value of listed bonds and other long-term borrowings was £17,507m (31 March 2018: £14,878m) and the carrying value was £16,212m (31 March 2018: £13,491m) and fair value of finance leases was £245m (31 March 2018: £253m) and carrying value was £218m (31 March 2018: £223m)

The fair value of the following financial assets and liabilities approximate to their carrying amount:

- Cash and cash equivalents
- Trade and other receivables
- Trade and other payables
- Provisions
- Investments held at amortised cost
- Other short term borrowings
- Investments classified as loans and receivable
- Contract assets
- Contract liabilities

The group's activities expose it to a variety of financial risks: market risk (including interest rate risk and foreign exchange risk); credit risk; and liquidity risk. There have been no changes to the risk management policies which cover these risks since 31 March 2018.

Fair value estimation

IFRS9 introduces three new categories of financial assets, fair value through profit and loss, fair value through other comprehensive income and amortised cost. At 31 March 2018 assets held at fair value included £2,575m of investments in liquidity funds, held as available for sale. These investments are held with the objective of collecting contractual cashflows. Under IFRS 9 they have therefore been classified as amortised cost. All other assets which were previously held as available for sale are now held as fair value through other comprehensive income.

These instruments are further analysed by three levels of valuation methodology which are:

1. Level 1 – uses quoted prices in active markets for identical assets or liabilities
2. Level 2 – uses inputs for the asset or liability other than quoted prices, that are observable either directly or indirectly
3. Level 3 – uses inputs for the asset or liability that are not based on observable market data, such as internal models or other valuation methods.

The fair values of the group's outstanding derivative financial assets and liabilities were estimated using discounted cash flow models and market rates of interest and foreign exchange at the balance sheet date.

| | Level 1 | Level 2 | Level 3 | Total held at fair value |
|---|-----------|--------------|-----------|--------------------------|
| 30 September 2018 | £m | £m | £m | £m |
| Investments | | | | |
| Fair value through other comprehensive income | 38 | - | 15 | 53 |
| Fair value through profit and loss | 6 | - | - | 6 |
| Derivative assets | | | | |
| Designated in a hedge | - | 1,521 | - | 1,521 |
| Fair value through profit and loss | - | 257 | - | 257 |
| Total assets | 44 | 1,778 | 15 | 1,837 |
| Derivative liabilities | | | | |
| Designated in a hedge | - | 564 | - | 564 |
| Fair value through profit and loss | - | 195 | - | 195 |
| Total liabilities | - | 759 | - | 759 |

| | Level 1 | Level 2 | Level 3 | Total held at fair value |
|------------------------------------|-----------|--------------|-----------|--------------------------|
| 31 March 2018 | £m | £m | £m | £m |
| Investments | | | | |
| Available for sale | 32 | 2,575 | 14 | 2,621 |
| Fair value through profit and loss | 7 | - | - | 7 |
| Derivative assets | | | | |
| Designated in a hedge | - | 1,248 | - | 1,248 |
| Fair value through profit and loss | - | 261 | - | 261 |
| Total assets | 39 | 4,084 | 14 | 4,137 |
| Derivative liabilities | | | | |
| Designated in a hedge | - | 628 | - | 628 |
| Fair value through profit and loss | - | 209 | - | 209 |
| Total liabilities | - | 837 | - | 837 |

No gains or losses have been recognised in the income statement in respect of Level 3 assets held at 30 September 2018. There were no changes to the valuation methods or transfers between levels 1, 2 and 3 during the half year.

9 Share capital

In the half year to 30 September 2018, 7.8m shares (H1 2017/18: 32.1m) at a total cost of £24m (H1 2017/18: £109m), calculated at a weighted average cost per share, were transferred from own shares to satisfy obligations under all-employee and executive share plans. We received cash proceeds of £2m (H1 2017/18: £46m). Own shares of £9m (H1 2017/18: £221m) were purchased during the half year. The majority of the shares transferred from own shares were to satisfy all-employee share option maturities.

10 Financial commitments

Capital expenditure for property, plant and equipment and software contracted for at the balance sheet date but not yet incurred was £1,293m (30 September 2017: £875m; 31 March 2018: £993m). Programme rights commitments, mainly relating to football broadcast rights for which the licence period has not yet started, were £2,866m (30 September 2017: £1,955m; 31 March 2018: £2,823m).

11 Dividend

The Board has declared an interim dividend of 4.62p per share, totalling £458m (Q2 2017/18: £480m). It will be paid on 4 February 2019 to shareholders on the register on 28 December 2018. The ex-dividend date is 27 December 2018. The election date for participation in BT's Dividend Investment Plan in respect of this dividend is 28 December 2018. The final dividend for the year to 31 March 2018 of 10.55p, amounting to £1,045m, was approved at the Annual General Meeting on 11 July 2018 and paid on 3 September 2018.

12 Contingent liabilities

Save for the updates provided below, there have been no material updates relating to the Legal Proceedings and Regulatory matters as disclosed in the Annual Report 2018.

Italian business – US securities class action complaints

On 1 August 2018 our motion to dismiss the first amended complaint filed in the District of New Jersey in November 2017 was granted, without prejudice to the filing of a second amended complaint which was filed on 1 October 2018. On 29 October 2018 we filed our motion to dismiss this second amended complaint.

13 Post balance sheet events

Changes in our segments

From 1 October 2018, our existing Business and Public Sector and Wholesale and Ventures divisions will be brought together into a combined division, Enterprise, to accelerate transformation, simplify our operating model and strengthen accountabilities. These businesses operated and were reported separately throughout the first half of the 2018/19 financial year and therefore have been presented as separate operating segments throughout these accounts. In the first half of the year there were £10m of internal revenue and costs between Business and Public Sector and Wholesale and Ventures.

Following our commitment to Ofcom in 2017 BT Group has completed the transfer of 31,000 employees to Openreach Limited from 1 October 2018, marking the final step in the creation of a more independent, legally separate business. As part of this, BT Northern Ireland Networks was renamed Openreach Northern Ireland and will be reported as part of Openreach (previously Business and Public Sector (Enterprise)).

There is no impact on total group results, balance sheet or cash flows as a result of these changes.

BT's pension schemes

On 26 October, the High Court handed down a judgment involving the Lloyds Banking Group's defined benefit pension schemes. The judgment concluded the schemes should be amended to equalise pension benefits for men and women in relation to guaranteed minimum pension benefits. The issues determined by the judgment arise in relation to many other defined benefit pension schemes. We are working with the trustees of our pension schemes, and our actuarial and legal advisers, to understand the extent to which the judgment crystallises additional liabilities for BT's pension schemes. We estimate this could be in the hundreds of millions of pounds, and any adjustment necessary is expected to be recognised in the second half of 2018/19.

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 44 to 54 of the Annual Report 2018 and are summarised below. All of them have the potential to have an adverse impact on our business, revenue, profits, assets, liquidity and capital resources.

- The risks associated with operating under a wide range of local and international laws, trade sanctions and import and export controls; coupled with the risk of inappropriate and unethical behaviour by our people or associates
- The risks arising from operating as a major data controller and processor of customer information around the world
- The risks arising from our operational activities, and in particular the work of our engineers, that are subject to health and safety regulation and enforcement by national authorities. This also extends to the risks associated with the transmission of radio waves from mobile telephones, transmitters and associated equipment – although according to the World Health Organisation there are no known adverse effects on health from emissions at levels below internationally recognised health and safety standards
- The risks arising from operating in markets which are characterised by: high levels of change; strong and new competition; declining prices and in some markets declining revenue; technology substitution; market and product convergence; customer churn; and regulatory intervention to promote competition and reduce wholesale prices
- The risks associated with some of our activities being subject to significant price and other regulatory controls
- The risks associated with a significant funding obligation in relation to our defined benefit pension schemes, and in particular the BT Pension Scheme
- The risks associated with political and geopolitical trends and incidents, including the uncertainty caused by the UK voting to leave the European Union
- The financial risks common to other major international businesses, including market, credit, liquidity and tax risks
- The risks that could impact the security of our data or the resilience of our operations and services
- The risks associated with complex and high value national and multinational customer contracts
- The risk there could be a failure of any of our critical third-party suppliers to meet their obligations
- The risks associated with not being able to secure sufficient employee engagement to support delivery of our strategic aims

There have been no significant changes to the principal risks and uncertainties in the half year to 30 September 2018. These principal risks and uncertainties continue to have the potential to impact our results or financial position during the remaining six months of the financial year.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

We confirm that to the best of our knowledge:

- the condensed set of financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting as adopted by the EU;
- the interim management report includes a fair review of the information required by:
 - a) DTR 4.2.7R of the Disclosure Guidance and Transparency Rules, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and
 - b) DTR 4.2.8R of the Disclosure Guidance and Transparency Rules, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last annual report that could do so.

By order of the Board

Gavin Patterson
Group Chief Executive

Simon Lowth
Group Chief Financial Officer

31 October 2018

INDEPENDENT REVIEW REPORT TO BT GROUP PLC

Conclusion

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 September 2018 which comprises the condensed consolidated income statement, statement of comprehensive income, balance sheet, statement of changes in equity, cash flow statement and related explanatory notes.

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-yearly financial report for the six months ended 30 September 2018 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as adopted by the EU and the Disclosure Guidance and Transparency Rules (“the DTR”) of the UK’s Financial Conduct Authority (“the UK FCA”).

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 UK. 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. We read the other information contained in the half-yearly financial report and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) 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.

Directors’ responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

The annual financial statements of the group are prepared in accordance with International Financial Reporting Standards as adopted by the EU. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 as adopted by the EU.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached.

Antony Cates
for and on behalf of KPMG LLP
Chartered Accountants

15 Canada Square
London
E14 5GL

31 October 2018

Additional Information

Notes

- 1) Our commentary focuses on the trading results on an adjusted basis, which is a non-GAAP measure, being before specific items. The directors believe that presentation of the group's results in this way is relevant to an 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. This is consistent with the way that financial performance is measured by management and reported to the Board and the Executive Committee 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. Reported revenue, reported operating costs, reported operating profit, reported profit before tax, reported net finance expense and reported EPS are the equivalent unadjusted or statutory measures. Reconciliations of reported to adjusted revenue, operating costs, operating profit, profit before tax and EPS are set out in the Group income statement. Reconciliations of underlying revenue, earnings before interest, tax, depreciation and amortisation, net debt and free cash flow from the nearest measures prepared in accordance with IFRS are provided in this Additional Information.
- 2) Trends in underlying revenue are non-GAAP measures which seek to reflect the underlying performance of the group that will contribute to long-term sustainable growth. As such this excludes the impact of acquisitions or disposals, foreign exchange movements and specific items.

Reconciliation of earnings before interest, tax, depreciation and amortisation

Earnings before interest, tax, depreciation and amortisation (EBITDA) is not a measure defined under IFRS, but is a key indicator used by management to assess operational performance. We consider EBITDA and adjusted EBITDA to be useful measures of our operating performance because they approximate the underlying operating cash flow by eliminating depreciation and amortisation. EBITDA and adjusted EBITDA are not direct measures of our liquidity, which is shown by our cash flow statement, and need to be considered in the context of our financial commitments. A reconciliation of reported profit for the period to EBITDA and adjusted EBITDA is provided below.

| | Half year to 30 September | |
|---|------------------------------|------------------------|
| | 2018 (IFRS 15) £m | 2017 (IAS 18) £m |
| Reported profit for the period | 1,052 | 809 |
| Tax | 288 | 275 |
| Reported profit before tax | 1,340 | 1,084 |
| Net interest related finance expense | 276 | 245 |
| Depreciation and amortisation | 1,736 | 1,757 |
| EBITDA | 3,352 | 3,086 |
| EBITDA specific items | 248 | 387 |
| Net other finance expense | 76 | 123 |
| Share of post tax losses (profits) of associates and joint ventures | (1) | - |
| Adjusted¹ EBITDA | 3,675 | 3,596 |

¹ See Glossary on page 2

Free cash flow

Free cash flow and normalised free cash flow are not measures defined under IFRS but are key indicators used by management to assess liquidity. However, we also believe they are important indicators of our overall operational performance as they reflect the cash we generate from operations after capital expenditure and financing costs, both of which are significant ongoing cash outflows associated with investing in our infrastructure and financing our operations. In addition, normalised free cash flow excludes cash flows that are determined at a corporate level independently of ongoing trading operations such as dividends, share buybacks, acquisitions and disposals, and repayment and raising of debt. Normalised free cash flow is not a measure of the funds that are available for distribution to shareholders.

A reconciliation from cash flow from operating activities, the most directly comparable IFRS measure, to free cash flow and normalised free cash flow, is set out below.

| | Half year to 30 September | |
|--|------------------------------|---------|
| | 2018 | 2017 |
| | £m | £m |
| Cash inflow from operating activities | 964 | 2,766 |
| Tax paid | (210) | (181) |
| Net cash inflows from operating activities | 754 | 2,585 |
| Net purchase of property, plant and equipment and software | (1,736) | (1,654) |
| Free cash flow¹ | (982) | 931 |
| Interest received | 8 | 2 |
| Interest paid | (236) | (259) |
| Add back pension deficit payments | 2,012 | 10 |
| Add back net cash flow from specific items | 277 | 589 |
| Remove refund on acquisition of spectrum licence | (21) | - |
| Remove cash tax benefit of pension deficit payments | (84) | (28) |
| Normalised free cash flow¹ | 974 | 1,245 |

¹ See Glossary on page 2

Net Debt

Net debt is not a measure defined under IFRS but is a key indicator used by management to assess both the group's cash position and its indebtedness. A reconciliation from loans and other borrowings, cash and cash equivalents, and current asset investments, the most directly comparable IFRS measures, to net debt, is set out below.

| | 30 September 2018 | 30 September 2017 | 31 March 2018 |
|---|----------------------|----------------------|------------------|
| | £m | £m | £m |
| Loans and other borrowings | 17,069 | 14,065 | 14,275 |
| Cash and cash equivalents | (431) | (353) | (528) |
| Current asset investments | (3,359) | (2,572) | (3,022) |
| | 13,279 | 11,140 | 10,725 |
| Adjustments: | | | |
| To re-translate currency denominated balances at swapped rates when hedged ¹ | (1,116) | (1,313) | (874) |
| To remove fair value adjustments and accrued interest applied to reflect the effective interest method ² | (268) | (307) | (224) |
| Net debt³ | 11,895 | 9,520 | 9,627 |

¹ The translation difference between spot rate and hedged rate of loans and borrowings denominated in foreign currency

² Includes remaining fair value adjustments made on certain loans and other borrowings and accrued interest at the balance sheet date

³ See Glossary on page 2

Reconciliation of year on year trends in underlying revenue

Year on year trends in underlying revenue seeks to reflect the underlying performance that will contribute to long-term profitable growth. A reconciliation from the trend in reported revenue, the most directly comparable IFRS measure, to the trend in underlying revenue, is set out below.

| | Half year to 30 September 2018 |
|---|-----------------------------------|
| | % |
| Decrease in reported revenue (IAS 18) | (1.7) |
| Specific items (IAS 18) | 0.2 |
| IFRS 15 adjustment | 0.3 |
| Decrease in adjusted¹ revenue (IFRS 15 pro forma) | (1.2) |
| Foreign exchange movements | 0.3 |
| Decrease in underlying¹ revenue | (0.9) |

¹ See Glossary on page 2

Reconciliation of year on year trends in adjusted earnings before interest, tax, depreciation and amortisation

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

| | Half year to 30 September 2018 |
|--|--------------------------------------|
| | % |
| Increase (decrease) in EBITDA (IAS 18) | 6.8 |
| Specific items (IAS 18) | (4.6) |
| IFRS 15 adjustment | (0.3) |
| Decrease in adjusted¹ EBITDA (IFRS 15) | 1.9 |

¹ See Glossary on page 2

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: our outlook for 2018/19 including revenue, EBITDA, free cash flow and dividend policy; our investment in FTTP, the deployment of ultrafast broadband and Gfast technology; and our investment in 4G and 5G network switch on.

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 whether as a result of the uncertainties arising from the UK's exit from the EU or otherwise; future regulatory and legal actions, decisions, outcomes of appeal and conditions or requirements in BT's operating areas, including the outcome of Ofcom's determination on broadband USO; the implementation of the DCR commitments, as well as competition from others; consultations and market reviews; selection by BT and its customer facing units 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, or impact on customer service; developments in the convergence of technologies; external threats to cyber security, data or resilience; political and geo-political risks; the anticipated benefits and advantages of new technologies, products and services not being realised, including the proposed investment in our FTTP broadband network; the timing of entry and profitability of BT in certain markets; significant changes in market shares for BT and its principal products and services; the underlying assumptions and estimates made in respect of major customer contracts proving unreliable; the anticipated benefits, synergies and cost savings of the EE integration not being delivered; the improvements to the control environment proposed following the investigations into BT's Italian business not being implemented successfully, effectively or timeously across the Group; 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.

About BT

BT's purpose is to use the power of communications to make a better world. It is one of the world's leading providers of communications services and solutions, serving customers in 180 countries. Its principal activities include the provision of networked IT services globally; local, national and international telecommunications services to its customers for use at home, at work and on the move; broadband, TV and internet products and services; and converged fixed-mobile products and services. BT consists of five customer-facing units of business: Consumer, Business and Public Sector, Wholesale and Ventures, Global Services, 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.

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